No. ___

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

H&R BLOCK, INC.; H&R BLOCK SERVICES, INC.;
H&R BLOCK EASTERN TAX SERVICES, INC.;
BLOCK FINANCIAL CORP.; and HRB ROYALTY, INC.,
Petitioners,

v.

LYNNE A. CARNEGIE, on behalf of herself
and all others similarly situated,
Respondent.

**Petition for a Writ of Certiorari to the
United States Court of Appeals
for the Seventh Circuit**

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether in applying the predominance requirement under Fed. R. Civ. P. 23(b)(3) in a case premised on mail or wire fraud under the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961-1968, the court should ignore the fact that each class member must individually prove reliance in order to establish a meritorious claim?

2. Whether, when a defendant has previously entered into a class settlement that is later rejected by the court, that defendant may properly be held to be judicially estopped from raising concerns about compliance with most of the Rule 23 requirements for class certification and to have waived any defenses not specifically identified during the class settlement approval proceedings.

PARTIES TO THE PROCEEDING AND CORPORATE DISCLOSURE STATEMENT

In addition to the petitioners and respondent listed in the caption, the parties in the U.S. Court of Appeals for the Seventh Circuit include Household International, Inc., Household Bank, f.s.b., successor in interest to Beneficial National Bank, Household Tax Masters, Inc., formally known as Beneficial Tax Masters, Inc., and Beneficial Franchise Company, Inc.

Petitioner H&R Block, Inc., is a publicly held company traded on the New York Stock Exchange. Each of the other petitioners is a direct or indirect subsidiary of H&R Block, Inc. No publicly held company owns 10% or more of the stock of H&R Block, Inc. and no publicly held company other than H&R Block, Inc. owns 10% or more of any of the other petitioners.

TABLE OF CONTENTS

QUESTIONS PRESENTED i
PARTIES TO THE PROCEEDING AND CORPORATE DISCLOSURE STATEMENT ii
TABLE OF AUTHORITIES iv
OPINIONS BELOW 1
JURISDICTION 1
STATUTES INVOLVED 1
STATEMENT 2
A. Background and Procedural History 3
B. The Opinion Below 7
REASONS FOR GRANTING THE PETITION 11
I. The Court Should Resolve the Split Over Whether and How Courts in RICO Fraud Cases Should Take Into Consideration the Need to Prove Individual Reliance When Determining Whether Common Issues Predominate Under Rule 23(b)(3). 14
II. The Court Should Clarify Whether a Defendant's Agreement To a Class Settlement or its Failure To Raise Potential Merits Defenses at a Settlement Hearing Can Support a Finding of Judicial Estoppel or Waiver. 23
A. Judicial Estoppel 24
B. Waiver 29
CONCLUSION 30

TABLE OF AUTHORITIES

CASES

Amchem Products, Inc. v. Windsor, 521 U.S. 591 (1997) 22, 25, 27, 28-29

Bank of China, New York Branch v. NBM LLC, 359 F.3d 171 (2d Cir. 2004) 15, 16

Basic Inc. v. Levinson, 485 U.S. 224 (1988) 20

In re Bendectin Litigation, 857 F.2d 290 (6th Cir. 1988) 20

In re Bridgestone/Firestone, Inc. Tires Products Liability Litigation, 333 F.3d 763 (7th Cir. 2003) 6, 13

Broussard v. Meineke Discount Muffler Shops, Inc., 155 F.3d 331 (4th Cir. 1998) 17-18

Buford v. H&R Block, 168 F.R.D. 340 (S.D. Ga. 1996), *aff'd, sub nom. Jones v. H&R Block Tax Services*, 117 F.3d 1433 (11th Cir. 1997) (unpublished table decision) 6, 9, 10-11, 19, 22

Castano v. American Tobacco Co., 84 F.3d 734 (5th Cir. 1996) 16

Exxon Co. v. Sofec, Inc., 54 F.3d 570 (9th Cir. 1995), *aff'd*, 517 U.S. 830 (1996) 20

In re Ford Motor Co. Bronco II Product Liability Litigation, 177 F.R.D. 360 (E.D. La. 1997) 26, 29

In re General Motors. Corp. Pick-Up Truck Fuel Tank Products Liability Litigation, 55 F.3d 768 (3d Cir. 1995) 26, 28

General Telephone Co. of Southwest v. Falcon, 457 U.S. 147 (1982) 28

Gunnells v. Healthplan Services, Inc., 348 F.3d 417 (4th Cir. 2003), *cert. denied*, 124 S. Ct. 2837 (2004) 17

Holmes v. Securities Investor Protection Corp., 503 U.S. 258 (1992) 15, 18, 19

Klay v. Humana, Inc., No. 02-16333, 382 F.3d 1241, 2004 WL 1938845 (11th Cir. Sept. 1, 2004) 17, 19

Moore v. PaineWebber, Inc., 306 F.3d 1247 (2d Cir. 2002) 21

New Hampshire v. Maine, 532 U.S. 742 (2001) 24, 25

Poulos v. Caesars World, Inc., 379 F.3d 654 (9th Cir. 2004) 17, 18, 19, 22

Sandwich Chef of Texas, Inc. v. Reliance National Indemnity Insurance Co., 319 F.3d 205 (5th Cir. 2003), *cert. denied*, 124 S. Ct. 101 (2003) 12, 15, 16, 21-22

Sikes v. Teleline, Inc., 281 F.3d 1350 (11th Cir. 2002) 17, 22

Suter v. Artist M., 503 U.S. 347 (1992) 27

Systems Management, Inc. v. Loiselle, 303 F.3d 100 (1st Cir. 2002) 15

STATUTES AND RULES

Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961-1968 4

28 U.S.C. § 1254(1) 1

Fed. R. Civ. P. 23 ..... *passim*

Fed. R. Civ. P. 23(b)(3) ..... *passim*

Fed. R. Civ. P. 23(e)(1)(C) 4

Fed. R. Civ. P. 23(f) 7

Fed. R. Civ. P. 23 advisory note..... 18

Fed. R. Evid. 408..... 27

MISCELLANEOUS

4 Alba Conte & Herbert Newberg, *Newberg on Class Action* (4th ed. 2002)..... 26, 28

Manual for Complex Litigation (Fourth) (Federal Judicial Center 2004) 26

PETITION FOR WRIT OF CERTIORARI

Petitioners H&R Block, Inc., *et al.* petition for a writ of certiorari to review a decision of the United States Court of Appeals for the Seventh Circuit.

OPINIONS BELOW

The opinion of the Seventh Circuit Court of Appeals affirming the grant of class certification is reported at 376 F.3d 656 and is reproduced in Appendix A at 1a-12a. The decision of the U.S. District Court for the Northern District of Illinois granting class certification is reported at 220 F.R.D. 542 and is reproduced in Appendix B at 13a-27a. The previous opinion of the Seventh Circuit reversing the District Court's approval of class settlement is reported at 288 F.3d 277 and reproduced in Appendix C at 28a-47a, and the District Court's decision on remand declining to approve the class settlement is reported at 260 F. Supp. 2d 680 and reproduced in Appendix D at 48a-75a.

JURISDICTION

The Court of Appeals entered judgment on July 16, 2004. The jurisdiction of the Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Rule 23 of the Federal Rules of Civil Procedure provides in pertinent part:

> (b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:
>
> * * *
>
> (3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual

members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

STATEMENT

Petitioners – H&R Block, Inc., and several of its affiliate companies – seek review of a decision of the Seventh Circuit affirming the district court's certification of a nationwide class of plaintiffs pursuing a RICO claim against them and certain other defendants, based on their role in making available loans offered to their customers. The Seventh Circuit, which described this case as raising "novel issues whose prompt resolution is important to the development to the law of class actions," Pet. App. 2a, adopted a new approach to analyzing the predominance requirement for class certification in RICO mail and wire fraud claims that virtually mandates certification in most cases involving allegations of widespread consumer fraud. That new rule conflicts directly with the approach adopted by the Fifth Circuit and other circuits, which require due consideration of the need to prove reliance on a person-by-person basis when a court is deciding whether common issues "predominate" under Fed. R. Civ. P. 23(b)(3).

The Seventh Circuit also applied principles of judicial estoppel and waiver to limit the arguments that can be made

by a defendant that previously agreed to a class settlement which was later rejected by the court. When such a case proceeds to full litigation, the defendant, the court held, is estopped from raising any objection to class certification, except for concerns about the manageability of the trial. The defendant will also be treated as having waived any defense it failed to articulate specifically during the settlement proceedings. These novel rulings involving the impact of a prior unsuccessful class settlement are indefensible both legally and practically. They require review as well.

A. Background and Procedural History

Petitioners provide income tax preparation services for individual taxpayers. During the relevant time period, their customers who chose to file their taxes electronically and were entitled to a refund became eligible to apply for Refund Anticipation Loans ("RALs") from Beneficial National Bank ("Beneficial"). RALs are short-term loans secured by, and payable from, the tax refund that customers expect to receive from the Internal Revenue Service. Beneficial is the lender on the loans.

The original named plaintiffs in this case filed suit in the Northern District of Illinois in April 1998 against H&R Block, Inc., some of its affiliates, and two Beneficial affiliates on behalf of themselves and a proposed nationwide class of plaintiffs who received RALs. They asserted a number of claims based on alleged fraud in administration of the RALs, including allegations that the loan terms were misrepresented in RAL advertisements and the loan documents, and that customers were unaware that H&R Block, Inc. or its affiliates received compensation from the lender. The named plaintiffs alleged that this arrangement constituted a scheme to defraud in violation of mail and wire fraud statutes, forming the basis of a violation of the

Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961-1968.

In October 1999, before the issue of class certification had been addressed by the court, the parties entered into a global settlement of all claims.[1] The Settlement Agreement contained a specific reservation-of-rights clause:

> In the event that the settlement does not become final in accordance with the terms hereof, then this Agreement shall be of no force or effect and, in any event. . . . Household[2] and H&R Block expressly reserve all their rights if the settlement does not become final in accordance with the terms of this Agreement, including their rights to contest class certification in [this case].

Pet. App. 76a-77a (footnote added). The Settlement Agreement defined the class, with certain exceptions, as all persons who had received RALs from Beneficial or through an H&R Block office between January 1, 1987, and October 26, 1999.[3] All told, the settlement class included over 17 million people. Notice was given to class members, one million of whom submitted claims under the settlement fund but some of whom challenged the settlement as unfair.

At a fairness hearing convened pursuant to Fed. R. Civ. P. 23(e)(1)(C), certain class member objectors, including respondent Carnegie, appeared and raised concerns about adequacy of representation and fairness of the settlement.

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[1] No H&R Block affiliate was at that time still a defendant, since all had previously been dismissed. However, H&R Block, Inc. agreed, as part of the global settlement, to the filing of an amended complaint naming it and making it a party for purposes of the settlement.

[2] Household Bank, f.s.b. is the successor-in-interest to Beneficial.

[3] Some sub-categories of claimants were excluded from the definition, though that fact is not material to the issues in this Petition.

But in July 2000, the district court (per Zagel, J.) approved the settlement as fair, adequate, and reasonable and the objectors appealed.

The Seventh Circuit reversed the district court's approval of the settlement, in a decision that is not challenged in this petition. The court concluded that the original plaintiffs' attorneys almost certainly had not provided adequate representation and that the district court had not adequately scrutinized the financial adequacy of the settlement. Pet. App. 35a, 38a-39a. Thus, the court concluded that the district court had abused its discretion in approving the settlement, but, without sufficient information in the record to make the determination itself, remanded for further consideration. Pet. App. 29a, 41a.

On remand, the district court (per Bucklo, J., to whom the case was reassigned) held further fairness hearings and ultimately declined to approve the class settlement under Fed. R. Civ. P. 23. The court found both that "counsel for the settlement plaintiffs have been inadequate representatives of the plaintiff class" for an array of reasons and that counsel "have failed to sustain their burden of showing that this settlement is fair." Pet. App. 74a. In particular, the court noted that the inadequacy of representation meant that "it is impossible to evaluate the chances of plaintiffs obtaining a greater recovery than under this settlement with any greater precision than noted in this opinion." *Id.*

After that ruling, the court removed the original class representatives and class counsel. Judge Bucklo substituted a new named plaintiff, respondent Carnegie, and new counsel. She gave respondent leave to file a second amended complaint, which added several additional defendants and several new claims. Although the class had never been formally certified by the district court, and, indeed, the settlement that defined the class had been repudiated, the

district court proceeded as if the class had been certified. Thus, it was defendants who were directed over their objections to file the first briefs arguing why the settlement class should no longer proceed to litigation on the merits on a class basis.

In particular, the defendants argued that the RICO claims were unsuitable for class treatment because the need for a factfinder to find reliance on the alleged misrepresentations by each individual class member meant that plaintiffs could not meet the Rule 23(b)(3) requirement that common issues predominate over individual issues. Further, they argued that the plaintiffs were precluded from seeking certification by application of the Seventh Circuit's holding in *In re Bridgestone/Firestone, Inc. Tires Products Liability Litigation*, 333 F.3d 763 (7th Cir. 2003), which held that a prior judicial finding by a federal court that a nationwide class should not be certified generally collaterally estops all members of the previously proposed class from seeking certification of a similar nationwide class elsewhere. They asserted that, under *Bridgestone/Firestone*, a previous decision in a Georgia district court, *Buford v. H&R Block, Inc.*, 168 F.R.D. 340 (S.D. Ga. 1996), *aff'd. sub nom. Jones v. H&R Block Tax Services*, 117 F.3d 1433 (11th Cir. 1997) (*per curiam*) (unpublished table decision), which denied certification of a similar nationwide class asserting RICO claims based on Block's RAL activities, should bar class certification in this case.

In a March 29, 2004, order, the district court rejected these arguments against certification of a RICO class. It said nothing about the predominance standard as it applied to the RICO claim. Pet. App. 20a-21a. Addressing the collateral estoppel argument, the court held that the defendants "waived this defense by failing to raise it when the Seventh Circuit and this court were considering whether the

settlement should be approved." *Id.* at 20a. Thus, the district court suggested that failure to raise a potential defense when seeking approval of a proposed class settlement operates as a waiver of the defense altogether, even after the settlement is rejected.[4] The defendants then pursued a discretionary appeal under Fed. R. Civ. 23(f).

B. The Opinion Below

The Seventh Circuit granted the petitions to appeal and issued a decision on the merits simultaneously, prior to any merits briefing or scrutiny of the record below. The court first noted that the case raised "novel issues whose prompt resolution is important to the development of the law of class actions as well as to the resolution of the present case." Pet. App. 2a. It then turned to the arguments the defendants had said they intended to present on appeal.

As a preliminary point, the court noted that the fact that the settlement class had not been formally certified at any point in the proceedings was irrelevant, simply a "formal defect – a technical oversight that was surprising but from a practical standpoint inconsequential." Pet. App. 8a. The court found that "de facto certification . . . of a settlement class" had occurred when the settlement was initially approved in 2000 following notice to proposed settlement class members and consideration and rejection of objections. *Id.* Moreover, the court of appeals said that it read the trial court's ruling as imposing the burden of persuasion on the plaintiff to justify certification, rather than the objecting defendants. *Id.*

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[4] In contrast, the district court did address class certification of the state law claims and found that they were unmanageable in a nationwide class action due to state-by-state differences in law. It thus decertified the class as to the state claims. Pet. App. 23a-25a.

On the merits, the court first found that the defendants were barred by the doctrine of judicial estoppel from challenging the adequacy of a class certification on grounds other than manageability, because all of the other Rule 23 requirements were equally applicable to the previously approved settlement class. The court reasoned that the defendants had in effect urged that certification was appropriate when advocating that the district court accept the settlement. Thus, they "had urged the district court to accept the giant class as appropriate for a global settlement, had prevailed in their urging, and so are now precluded by the doctrine of judicial estoppel . . . from challenging its adequacy, at least as a settlement class." Pet. App. 4a (citation omitted). As a policy matter, the court reasoned that allowing what it described as inconsistent positions in successive stages of litigation would encourage fraud in the course of litigation. *Id.* at 5a. Further, the court found that the defendants benefited from the (albeit temporary) settlement of the case because other similar suits were temporarily enjoined, and that they "cannot now be permitted to seek a further benefit from reversing their position." *Id.*

Second, the court held that the defendants waived their collateral estoppel argument based on *Bridgestone/Firestone* and the Georgia district court's *Buford* decision denying certification of a comparable nationwide class. Even though *Bridgestone/Firestone* was not decided until 2003 (long after the first appeal from approval of the class settlement had been argued), the court held that the defendants waived any argument relying on *Bridgestone/Firestone* and *Buford* by failing to raise it during the settlement proceedings that occurred in 2000. Thus, "it is too late . . . to plead collateral estoppel when, though knowing of the *Buford* decision . . . they insisted until last year . . . that class treatment of the RICO claim was entirely appropriate." Pet. App. 11a. The court added that "collateral estoppel is an affirmative defense

that is forfeited if not raised in a timely manner, and it was not raised in a timely manner in this case." *Id.* As a related point, the court also held that the collateral estoppel argument was foreclosed, for the same reasons discussed above, by the doctrine of judicial estoppel. *Id.*[5]

Finally, analyzing the manageability of certifying a RICO mail and wire fraud claim for trial, the court found no bar posed by the need to assess separately, for each class member, the factual basis for a claim of reliance on the alleged fraudulent misrepresentation in various advertisements and loan documents, the terms of which varied over the class period at issue. Defendants' argument, mirroring the holding of the district court in *Buford*, was that individual issues relating to each class member's reliance would predominate over common issues at trial; because showing individual reliance – not simply the existence of some allegedly deceptive policy or practice – is an essential element of proving the fraud underlying this RICO claim, each individual would be required to demonstrate that he or she relied on a misrepresentation to his or her detriment. The court accepted the premise that individual fact-finding of reliance would be required, but rejected the argument against class certification by treating reliance as a factor to be considered in determining damages, rather than an essential element of the cause of action:

> The judge in *Buford* thought, however, that the issue of violation would be swamped by issues concerning whether the borrowers had been deceived - had relied on the fraud, and thus had been injured, whether directly . . . or . . . indirectly. Those issues would have to be resolved separately for each class

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[5] In so doing, the court barred even defendants who were not parties prior to the rejection of the class settlement from raising the collateral estoppel argument based on *Buford*.

> member. . . . The question whether RICO was violated can be separated from the question whether particular intended victims were injured, and thus can - or so a district court could determine without being thought to have abused its discretion - be resolved in a single proceeding with the issue of injury parceled out to satellite proceedings. . . .

Pet. App. 10a (citations omitted).

The court of appeals further explained that the burdensomeness of these satellite proceedings need not be much of a concern since, once a finding of a classwide scheme to defraud is made,

> a global settlement along the lines originally negotiated [here] (though presumably with different dollar figures) will be a natural and appropriate sequel. And if there is no settlement, that won't be the end of the world. Rule 23 allows district courts to devise imaginative solutions to problems created by the presence in a class action of individual damages issues.

Pet. App. 7a.

Thus, the court stated its belief that even in a class action (like this one) involving 17 million class members, there could be some procedure devised to arrive fairly at 17 million individual reliance determinations after a classwide finding of a scheme to defraud. But the court's real assumption clearly was that a defendant faced with that daunting prospect would have no choice but to settle for some sort of formulaic distribution of funds.

The Seventh Circuit explicitly acknowledged that its analysis and conclusion conflicted with the Fifth Circuit's strong presumption against class certification in RICO fraud cases as well as the Georgia District Court's decision in

Buford, which was affirmed by the Eleventh Circuit. Pet. App. 10a. This disagreement derives from a different understanding of the elements of liability in a civil RICO fraud case. The Seventh Circuit's newly stated view is that there is a distinction between "the question whether RICO was violated [and] the question whether the targets of the violation had been injured by the violation." *Id.* at 9a. It reasoned that the predicate acts in RICO fraud cases are violations of the mail and wire fraud statutes, and "these statutes are violated by a 'scheme or artifice to defraud' . . . whether or not the scheme succeeds and therefore causes injury." *Id.* (citing three cases involving criminal prosecutions under RICO). By contrast, as we note *infra*, the Fifth Circuit and other circuits recognize that individual reliance is an essential element of *liability* determinations in civil RICO fraud cases and thus must be adjudicated before any judgment of liability – classwide or otherwise – could be entered in a private civil RICO case.

REASONS FOR GRANTING THE PETITION

The Seventh Circuit's decision to approve the class certification in this case raises two important questions. The first relates to the one argument against certification that petitioners were allowed to raise after the class settlement fell through – the argument that in a RICO fraud trial involving 17 million class members, the effort to prove reliance individually would swamp any common issue. The Seventh Circuit created an acknowledged conflict with the rule prevailing in the Fifth Circuit, and an almost equally clear conflict with the rules applied in other circuits, in flatly holding that the need to prove individual reliance does not pose any barrier to class certification in RICO fraud cases. The Fifth Circuit has adopted a strong presumption against class certification in RICO fraud cases predicated on mail or wire fraud because, in its view, the requirement of showing

that each class member relied on the fraudulent statements to his or her detriment almost always means that individual issues predominate over classwide issues. *See, e.g., Sandwich Chef of Texas v. Reliance National Indemnity Co.*, 319 F.3d 205, 219 (5th Cir. 2003). Other circuits make this assessment on a case-by-case basis depending on the circumstances of each case. The Seventh Circuit, by contrast, has now held that the need to prove reliance can and should be ignored altogether in the class certification determination. This ruling rests on an incorrect assumption that detrimental reliance is not properly viewed as an element of the liability determination in private civil RICO fraud cases but instead comes up only in the assessment of damages. Left uncorrected, the ruling will sow confusion and lead to certification of numerous utterly unmanageable RICO class actions.

The second question presented relates to the ways in which, according to the Seventh Circuit, a defendant who settles a class action can be barred from fully litigating the case later on if the settlement is not judicially approved. In rulings that appear to be without precedent, the court of appeals applied the doctrines of judicial estoppel and waiver to curtail sharply petitioners' ability to argue against certification of a class in the wake of a ruling that a prior class settlement was unfair to absent class members.

First, the court held that petitioners, some of whom had agreed to the unsuccessful class settlement, were estopped from later raising concerns about compliance with any of the requirements for class certification other than manageability at trial. This rule not only will deter defendants from settling class actions but also makes no sense. When a class action is settled, the defendant has neither the responsibility nor the incentive to look out for the rights of the class that are safeguarded by Rule 23 certification standards. The

defendant simply makes the best deal possible. It follows that settling defendants should not be treated later as if they had made binding representations to the court that the settlement class satisfies certification standards. By contrast, when the issue is certification of a class for litigation on the merits, it is again the court's duty to assure compliance with Rule 23, but the defendant plays an important role as the one party present with an incentive to point out potential concerns to the court. The Seventh Circuit's rule assumes that there may be valid reasons under Rule 23 not to certify a class to litigate the case but still bars defendants from pointing out those concerns if they previously signed on to an unsuccessful class settlement. Such a rule can only hurt the absent class members who are the primary beneficiaries of the Rule 23 standards that the court remains dutybound to enforce throughout the proceedings.

Equally troubling was the Seventh Circuit's ruling that petitioners lost the right to assert a collateral estoppel defense against class certification as a result of the prior settlement. Long after the settlement had been signed and presented to the district court, the Seventh Circuit announced in *Bridgestone/Firestone* a new rule that all persons who were within the scope of a proposed class in one case where nationwide certification was denied by a federal court are later collaterally estopped from seeking nationwide certification of the same class to pursue the same claim in another court. Under this rule, it is undisputed that certification of a class would have been barred here. But when petitioners sought to raise that argument after the settlement was rejected and the district court was deciding whether to proceed with the case on a class basis, the courts below held that they had waived any defenses they did not assert as arguments in favor of approval of the class settlement. Leaving aside the fact that this supposed waiver occurred before the new collateral estoppel rule had even

been recognized, the Seventh Circuit's newly minted duty of a defendant to catalogue all of its potential defenses at a class settlement hearing – or forfeit them later – has no legal basis and serves no purpose. Defendants already have ample reason to describe the potential vulnerabilities of the plaintiffs' case in support of a settlement. But no rule requires that they say anything at all. And if they know that failure to identify some defense at that stage will lead to waiver later on, they will have yet another reason to avoid settling in the first place.

The Court should grant review to address the clear circuit conflict over certifying RICO fraud cases and to consider whether the Seventh Circuit went too far in imposing novel constraints on defendants' ability to challenge class certification or raise other defenses after a settlement has been rejected.

I. The Court Should Resolve the Split Over Whether and How Courts in RICO Fraud Cases Should Take Into Consideration the Need to Prove Individual Reliance When Determining Whether Common Issues Predominate Under Rule 23(b)(3).

The Seventh Circuit's new rule allows virtually automatic class certification in RICO fraud cases, at least where some of the alleged misrepresentations made to the class are allegedly uniform, because it treats as irrelevant the need to prove reliance on the misrepresentations individually. That rule conflicts with the law in the Fifth Circuit, as the Seventh Circuit explicitly acknowledged. It also conflicts with decisions from the other circuits that take a more nuanced approach to deciding when individual issues of reliance predominate over common issues. This split is particularly significant in light of the current spate of nationwide class actions, where plaintiff attorneys are able to forum-shop for favorable jurisdictions across the country. The direct split

among circuits, the relative frequency of this issue arising, and the high stakes for all parties in class certification decisions all argue in favor of this Court intervening now to resolve the split.

The position of the Fifth Circuit on RICO mail and wire fraud class certification was articulated most recently in *Sandwich Chef of Texas, Inc. v. Reliance National Indemnity Insurance Co.*, 319 F.3d 205 (5th Cir. 2003), *cert. denied*, 124 S. Ct. 101 (2003), the case that the Seventh Circuit disparaged as "dubious." Pet. App. 10a. The very first line of that decision reads: "Fraud actions that require proof of individual reliance cannot be certified as [Rule] 23(b)(3) class actions because individual, rather than common, issues will predominate." 319 F.3d at 211. The district court had certified a plaintiff class claiming mail and wire fraud under RICO. But the Fifth Circuit reversed, holding that individual reliance and causation issues would clearly predominate over common issues in the adjudication of the case.

In its decision, the Fifth Circuit first noted that proximate cause is an essential element of a civil RICO violation, *id.* at 218 (citing *Holmes v. Securities Investor Protection Corp.*, 503 U.S. 258 (1992)), and that proximate cause is necessarily demonstrated by showing individual reliance by each plaintiff on the misrepresentation, leading to injury, *id.* ("For a misrepresentation to cause an injury, there must be reliance.").[6] Thus, the court noted that each plaintiff, or

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[6] Although almost all courts have held that proving causation in a RICO mail or wire fraud case requires proof of individual reliance by the allegedly injured party, *see, e.g.*, *Bank of China, New York Branch v. NBM LLC*, 359 F.3d 171, 176-77 (2d Cir.) (summarizing cases), petition for cert. filed, No. 03-1559 (May 19, 2004), at least one Circuit has held that the proof of reliance is not required, *see Systems Management, Inc. v. Loiselle*, 303 F.3d 100, 103-04 (1st Cir. 2002). The split is immaterial in this case, because the plaintiff class's theory of recovery is premised on individual reliance on alleged misrepresentations by Block. Indeed, the

member of a plaintiff class, must demonstrate individual reliance on the alleged misrepresentations. *Id.* at 219. Finally, the court held that the issues of fact involved in showing individual reliance predominate over any common issues, such that "[t]he pervasive issues of individual reliance that generally exist in RICO fraud actions create a working presumption against class certification." *Id.* This holding is in accord with prior Fifth Circuit precedent. *E.g., Castano v. American Tobacco Co.*, 84 F.3d 734, 745 (5th Cir. 1996) (stating that "a fraud class action cannot be certified when individual reliance will be an issue" and criticizing district court for contemplating individual proceedings on reliance question).

The Seventh Circuit rejected the Fifth Circuit's approach and reached a totally contrary result. The court conceded that each class member must show individual reliance to prevail and that "[t]hose issues would have to be resolved separately for each class member." Pet. App. 10a. However, the court treated questions about individual reliance as involving "whether particular intended victims were injured," rather than "whether RICO was violated." *Id.* It therefore concluded that individual reliance issues cannot predominate. The court explained that fights about reliance could be "parcelled out to satellite proceedings" after the class won a liability judgment, but that this likely would not be necessary because defendants, having been held liable classwide and facing countless individual hearings, would have no choice

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Seventh Circuit brushed aside the split, recognizing that the issue in this case (as in *Buford*) is whether the individual reliance determinations may properly be severed from proof of the rest of the RICO violation when evaluating the predominance requirement. Pet. App. 10a. We note that in the *Bank of China* case, where the pending petition for certiorari raises the question whether proof of a reliance is required in civil RICO cases premised on bank fraud, the Court on October 12, 2004, issued an order requesting the views of the Solicitor General.

but to settle with all class members. In so reasoning, the court acknowledged the utter unmanageability of litigating thousands or millions of individual fraud claims in one case, but found solace in the prediction that the problem would be so bad that no defendant would demand its day (or more likely its 1,000 days) in court.

As noted, the Seventh Circuit's holding that individual reliance issues could simply be ignored in the class certification assessment – based on a novel notion that reliance is not really part of what constitutes a RICO "violation" – is also contrary to the law of other circuits beyond the Fifth. These courts take a more nuanced position between the presumption against class certification in RICO fraud cases in the Fifth Circuit and the presumption in favor in the Seventh Circuit. Yet all of them consider the question of reliance to be an essential element of the claim – and thus a factor to be given some weight in deciding whether to grant class certification. *See, e.g., Poulos v. Caesars World, Inc.*, 379 F.3d 654, 664-66 (9th Cir. 2004) (individual reliance issues predominate in particular case); *Sikes v. Teleline, Inc.*, 281 F.3d 1350, 1361-64 (11th Cir. 2002) (reversing district court and holding that individual issues of reliance in RICO mail and wire fraud claim predominate); *Klay v. Humana, Inc.*, No. 02-16333, 382 F.3d 1241, 2004 WL 1938845, at *8-*9 (11th Cir. Sept. 1, 2004) (individual reliance issues do not predominate under facts of case); *Gunnells v. Healthplan Servs., Inc.*, 348 F.3d 417, 436-37 (4th Cir. 2003) (finding that district court abused discretion in presuming reliance in fraud case and that individual reliance issues clearly predominate), *cert. denied*, 124 S. Ct. 2837 (2004); *Broussard v. Meineke Discount Muffler Shops, Inc.*, 155 F.3d 331, 342-43 (4th Cir. 1998) (stating that reliance elements of

fraud claim are not readily susceptible to class-wide proof and reversing class certification).[7]

The conflict with the Seventh Circuit's extreme position that the need to prove individual reliance should not even be considered at the certification stage is illustrated by the Ninth Circuit's analysis in *Poulos*:

> Causation lies at the heart of a civil RICO claim. Lumping claims together in a class action does not diminish or dilute this requirement. It is well settled that, to maintain a civil RICO claim predicated on mail fraud, a plaintiff must show that the defendants' alleged misconduct proximately caused the injury [citing *Holmes*, *supra*], . . . The misrepresentations standing alone have little legal significance. To connect the dots between the bare allegations and the injury, the class needs something more. Here, reliance provides a key causal link between the [defendants'] alleged misrepresentations and the Class Representatives' injury.

379 F.3d at 664-65. The court, while not conceding that individual issues would predominate in all cases, concluded

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[7] The Advisory Committee took a similar approach in a note accompanying the 1966 amendment to Fed. R. Civ. P. 23:

> It is only where . . . predominance exists that economies can be achieved by means of the class-action device. In this view, a fraud perpetrated on numerous persons by the use of similar misrepresentations may be an appeal situation for a class action, and it may remain so despite the need, if liability is found, for separate determination of the damages suffered by individuals within the class. On the other hand, although having some common core, a fraud case may be unsuited for treatment as a class action if there is material variation in the representations made *or in the kinds or degrees of reliance by the persons to whom they were addressed.*

(Emphasis added.)

on the facts of the case that they did clearly predominate over the common issues there. *Id.* at 665-66. The Seventh Circuit, by contrast, would have directed that a class be certified for a trial of the common issues, to be followed by "satellite proceedings" where it would be determined whether each class member individually has a valid claim.

The Eleventh Circuit's approach is similar to the Ninth's. As noted above, in *Buford*, it affirmed summarily a district court's ruling denying certification of a class to pursue claims nearly identical to those presented here. The district court had held that individual reliance issues would predominate over common issues. By contrast, in *Klay v. Humana, Inc.*, the Eleventh Circuit held on the facts of the case that substantial common questions of fact regarding the alleged common scheme and the presence of "circumstantial evidence that can be used to show reliance . . . common to the whole class" meant that the individual reliance issues did not predominate. 2004 WL 1938845, at *13. The court acknowledged that individual reliance issues do sometimes predominate but held that the reliance element "is not an absolute bar to class certification." *Id.* at *12. Again, this case-by-case approach is contrary to the absolutist position taken by the Seventh Circuit that individual reliance need not be considered at all.

The Seventh Circuit holding is also in tension with two decisions of this Court. First, by suggesting that the question of reliance is distinct from the question of a "RICO violation" the Seventh Circuit runs up against *Holmes v. Securities Investor Protection Corp.* In *Holmes*, 503 U.S. 258, 265-68 (1992), the Court clearly held that a civil RICO plaintiff must show proximate cause to prevail, which in this case requires proof of each individual class member's reliance. The Seventh Circuit, however, ignored *Holmes* and relied on *criminal* RICO precedent in holding that reliance is

not an element of liability but a matter solely of "injury." Pet. App. 9a.

Second, in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), the Court addressed in *dictum* the question whether the requirement of showing individual reliance precludes certification of a class under Rule 23(b)(3) in a fraud case. *Basic Inc.* was a securities fraud case where the Court held that reliance may be presumed under a "fraud on the market" theory that is unique to securities cases. *See* 485 U.S. at 241-42 (internal quotation marks omitted).[8] In support of that decision, the Court noted that "[r]equiring proof of individualized reliance from each member of the proposed plaintiff class effectively would have prevented [plaintiffs] from proceeding with a class action, since individual issues then would have overwhelmed the common ones." *Id.* at 242.

As these cases indicate, the Seventh Circuit is on shaky ground when suggesting that individualized proof of an essential element like reliance can be treated the same as individual questions about the *extent* of injury, which frequently do get considered in "satellite proceedings." The precedent cited by the Seventh Circuit does not remotely support treating causation issues such as reliance in this way. The two cases relied upon for the proposition that "the issue of injury [may be] parceled out to satellite proceedings, as is frequently done in class action tort litigation," see Pet. App. 10a (citing *Exxon Co. v. Sofec, Inc.*, 54 F.3d 570 (9th Cir. 1995), *aff'd*, 517 U.S. 830 (1996) and *In re Bendectin Litig.*, 857 F.2d 290 (6th Cir. 1988)), support no such thing; neither actually involves a class action, much less the particular requirements of Rule 23(b)(3), and thus neither provides any support for the notion that it is appropriate to try thousands or

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[8] No comparable argument for presuming reliance was made or could have been made here.

millions of individual reliance disputes in the "satellite" phase of a single case.

The Seventh Circuit also cited *Moore v. PaineWebber, Inc.*, 306 F.3d 1247, 1255-56 (2d Cir. 2002), but that case is equally unsupportive. The Second Circuit there affirmed a *denial* of class certification on predominance grounds in a fraud case. The focus of its analysis was the absence of uniform oral statements to proposed class members, so the case did not technically present the question whether the need to prove individual reliance can preclude certification. But the Second Circuit's analysis makes clear that it would disagree with the Seventh Circuit's approach to that question:

> We agree with these courts that *a common course of conduct is not enough to show predominance*, because a common course of conduct is not sufficient to establish liability of the defendant to any particular plaintiff. . . . In order to establish PaineWebber's liability, each plaintiff must prove that he or she personally received a material misrepresentation, *and that his or her reliance on this misrepresentation was the proximate cause of his or her loss*.

Id. at 1255 (citations omitted; emphasis added).

Ignoring the problems of proving individual reliance in this kind of case is certainly unwise as a practical matter. There is little doubt that the individual issues of fact necessary to show reliance are numerous and complex, a reality that the Seventh Circuit did not even challenge. For example, in order to show detrimental reliance in this case, each class member must show that the class member had no knowledge of the details of the RAL arrangement that were allegedly misrepresented, *cf. Sandwich Chef*, 319 F.3d at 218-19 ("[k]nowledge of the truth defeats a claim of fraud

because it eliminates the deceit as the 'but for' cause of the damages"), that the class member actually believed the alleged misrepresentation, *cf. Sikes*, 281 F.3d at 1364 ("each individual plaintiff may be the only person with critical information" about each alleged misrepresentation), and that the class member would not have agreed to take a RAL if he or she had known more about the financial arrangement, a proposition that requires inquiry into, *inter alia*, the individual financial circumstances of each class member at the times of taking out the RAL(s). *Cf. Buford*, 168 F.R.D at 360 ("[T]he question of whether class members who were fully informed of the loan arrangement would have still taken the loan remains an individualized determination."). This kind of series of individual issues is just as present in other fraud cases that, under the Seventh Circuit rule, are all amenable to class treatment because the reliance question is disregarded. *See, e.g., Poulos*, 379 F.3d at 665-66 (illustrating chains of causal links necessary to show reliance by casino gamblers). If not reversed, application of the Seventh Circuit standard will lead to certification of any number of unwieldy and unmanageable nationwide classes.

Viewed in light of the purpose of Rule 23, the Seventh Circuit's rule becomes even more indefensible. In damages cases brought pursuant to Rule 23(b)(3), the predominance inquiry serves to help guarantee the fairness of litigating claims together as a class. *See Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 623 (1997) ("The Rule 23(b)(3) predominance inquiry tests whether proposed classes are sufficiently cohesive to warrant adjudication by representation."). The Court should not allow this requirement to be circumvented by the trick of severing reliance – an essential element of the RICO claim – from the predominance inquiry as a whole.

Finally, the circuit split created by the Seventh Circuit is particularly glaring and in need of resolution because class action attorneys and named plaintiffs bringing nationwide class actions can pick and choose their forum according to the most favorable law. Indeed, in this case, the current named plaintiff, respondent Carnegie, obtained her RAL in New York, outside the Seventh Circuit. And the pronouncements of the Seventh Circuit opinion are quite sweeping, essentially inviting district courts to exclude reliance considerations, or other questions of causation, from the predominance inquiry in deciding class certification. Any plaintiff with aspirations of a class action based on RICO fraud would be foolish to file in the Fifth Circuit rather than the Seventh, since the question of class certification, as a practical matter, is often dispositive and raises particularly high stakes for all parties involved. The difference in law between circuits is essentially outcome determinative.

II. The Court Should Clarify Whether a Defendant's Agreement To a Class Settlement or its Failure To Raise Potential Merits Defenses at a Settlement Hearing Can Support a Finding of Judicial Estoppel or Waiver.

The Seventh Circuit's use of the doctrines of judicial estoppel and waiver to preclude the defendants from raising other potential objections to class certification also warrants review by this Court. The application of these doctrines flies in the face of established practice allowing a defendant to accept a settlement without losing possible defenses if the settlement falls through. It also reflects a misunderstanding of the role played by each of the parties when a court is considering a class settlement. More fundamentally, the Seventh Circuit's analysis is flawed as a policy matter for two reasons. First, it will discourage settlements by needlessly exposing defendants to potential harm when they

elect to settle. Second, by precluding defendants from raising arguments against certification after a class settlement is rejected, the Seventh Circuit's approach will also expose the class to greater risks as the case proceeds to be litigated, since there will then be no party with the incentive and ability to air concerns about compliance with Rule 23's safeguards. The Court should grant review to consider whether estoppel and waiver, as equitable doctrines, ought to be applied in such an unfair and potentially harmful manner.

A. Judicial Estoppel

The Court has eschewed "establish[ing] inflexible prerequisites or an exhaustive formula for determining the applicability of judicial estoppel." *New Hampshire v. Maine*, 532 U.S. 742, 751 (2001). Rather, recognizing that judicial estoppel is an equitable doctrine, the Court has isolated three factors to determine whether to apply the doctrine in any particular case. "First, a party's later position must be 'clearly inconsistent' with its earlier position." *Id.* at 750 (citing cases across circuits). Second, the party must have succeeded in persuading a court to accept the previous position, such that "judicial acceptance of an inconsistent position in a later proceeding would create 'the perception that either the first or the second court was misled,'" which threatens judicial integrity. *Id.* (citation omitted). Third, the party's inconsistent positions must have allowed the party to derive an unfair advantage or worked an unfair detriment upon the opposing party. *Id.* at 751. Given that inconsistent arguments are sometimes allowed – inconsistent pleadings, for example – the rule properly focuses on court reliance on a particular representation by a party followed by the party taking a clearly inconsistent position to persuade a court differently.

Here, the Seventh Circuit reasoned that the defendants were estopped from later raising questions about any of the

elements of the class certification inquiry that are relevant at the settlement stage (*i.e.*, everything but manageability[9]) because they had obtained a favorable judgment by successfully persuading the district court to accept the settlement before the first Seventh Circuit appeal. Pet. App. 4a-6a. In so doing, the court did not rely upon any specific representation made in the proceedings; rather, the court essentially charged the defendants with constructively making arguments that the proposed settlement class was properly certified because they advocated that the settlement be accepted. *See, e.g., id.* at 4a ("[T]he defendants had urged the district court to accept the giant class as appropriate for a global settlement, had prevailed in their urging, and so are now precluded by the doctrine of judicial estoppel . . . from challenging its adequacy, at least as a settlement class . . . .") (citing *New Hampshire v. Maine*).

This was problematic in principle for several reasons. First, the Seventh Circuit seemed to assume, incorrectly, that a settling defendant is charged by law with assessing the certifiability of a settlement class before joining with the named plaintiff and seeking approval of a class settlement. A defendant has no such obligation. Nor would it make sense to create such a duty, since it would put defendants in an impossible position – simultaneously looking out for the class while trying to obtain the best deal possible. It is up to the named plaintiffs and their counsel to assure that the class is properly structured and represented to assure fair treatment of all class members. Thus, when a settlement is presented for approval, the court has no basis for concluding that the

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[9] This Court held in *Amchem* that a court assessing a proposed settlement must assure that all of the Rule 23 standards are met, with the exception of the question whether the case would be manageable at trial. *Amchem Prods.*, 521 U.S. at 620. This is an example of the court's broader duty to assure compliance with Rule 23 throughout the litigation.

defendant is making any implied representation whatsoever about compliance with Rule 23.

More generally, parties are not, and should not be, precluded from litigating issues because they settled and the settlement was then rejected. It is standard practice for class settlements to be made subject to a reservation of any potential defenses the defendant might raise should the settlement be rejected. Here, for example, the Settlement Agreement provided that if the agreement did not become final for any reason, including rejection by the court, the defendants still reserved their litigation rights, "including their rights to contest class certification." Pet. App. 77a.

Moreover, the usual approach is to honor such a reservation, including with regard to issues of class certification. *See Manual for Complex Litigation (Fourth)* § 21.612, at 313 (Federal Judicial Center 2004) (settlement classes "permit defendants to settle while preserving the right to contest the propriety and scope of the class allegations if the settlement is not approved"); 4 Alba Conte & Herbert Newberg, *Newberg on Class Actions* § 11:27 at 48 (4th ed. 2002) ("[I]f the proposed class settlement is not ultimately approved, the defendants' stipulation for class certification is considered withdrawn, and procedurally, the defendants may contest class issues de novo."); *In re General Motors Corp. Pick-Up Truck Fuel Tank Prods. Liab. Litig.*, 55 F.3d 768, 790 (3d Cir. 1995) ("[S]ettlement classes may reduce litigation costs by allowing defendants to stipulate to class certification without forfeiting any of their legal arguments against certification should the negotiations fail."); *In re Ford Motor Co. Bronco II Prod. Liab. Litig.*, 177 F.R.D. 360, 364, 373-74, 376 (E.D. La. 1997) (denying class certification based on, among other grounds, necessity of proving individual reliance following rejection of proposed settlement based on inadequacy of representation and terms).

The reason, of course, is that absent the ability to reserve rights, defendants would be much less likely to settle class actions because of the risk that a settlement will not be judicially approved. That is the policy basis of the general rule that settlement does not concede or estop any rights of a party to litigate an issue should the settlement become inoperative. Indeed, statements made in settlement negotiations are generally not even admissible as evidence. *See* Fed. R. Evid. 408 ("[e]vidence of conduct or statements made in compromise negotiations" regarding a claim is not admissible as to validity of the claim). A party may make concessions in a settlement agreement without conceding that the remedies must be imposed by law, or even that a court has the power to impose the remedies by law. *See, e.g., Suter v. Artist M.*, 503 U.S. 347, 354 n.6 (1992) (party's consent to remedial action in consent decree in one action did not bar party's arguments that opponent was not entitled to seek similar relief in other action in part because "parties may agree to provisions in a consent decree which exceed the requirements of federal law" and consent decree "provide[d] that the decree is not an admission of any factual or legal issue").

The practice of allowing parties to reserve rights to contest class certification while agreeing to settle clearly supports the policy of encouraging settlement, because it returns both parties back to their respective pre-settlement positions if the settlement is rejected; the alternative is that a defendant would have to concede key defenses related to class certification as a cost of settling. Settlements are favored as a matter of public policy in class actions and this Court has described settlement classes as a "stock device." *Amchem*, 521 U.S. at 618. Indeed, avoiding the cost of *litigating class certification itself* by settlement is a winning proposition for the class members, defendants, and judicial resources:

> The law favors settlement, particularly in class actions and other complex cases where substantial judicial resources can be conserved by avoiding formal litigation. . . . The parties may also gain significantly from avoiding the costs and risks of a lengthy and complex trial. . . . These economic gains multiply when settlement also avoids the costs of litigating class status – often a complex litigation within itself. Furthermore, a settlement may represent the best method of distributing damage awards to injured plaintiffs, especially where litigation would delay and consume the available resources. . . .

General Motors Corp., 55 F.3d at 784 (citations omitted); *see also* 4 Newberg, *supra*, § 11:41 at 87 ("The compromise of complex litigation is encouraged by the courts and favored by public policy."). The Seventh Circuit's approach, by contrast, would discourage settlements because defendants would rightly fear that they could find themselves litigating the case with one hand tied behind their back.

But application of the doctrine of judicial estoppel is particularly problematic in this particular context for another reason. The primary purpose of the Rule 23 certification requirements is not to protect defendants but to protect absent class members whose legal claims are being litigated by representative plaintiffs. The court has an independent duty to scrutinize the Rule 23 requirements in order to ensure that due process is present. *See General Tel. Co. of Southwest v. Falcon*, 457 U.S. 147, 161 (1982) (district court may only certify a class after "rigorous analysis" of the Rule 23 requirements to ensure that the certification is fair to members of the absent class). And the "dominant concern" in evaluating the Rule 23(a) and (b) requirements is "whether a proposed class has sufficient unity so that absent class

members can fairly be bound by decisions of class representatives." *Amchem*, 521 U.S. at 621. This duty to protect the class exists throughout the case, including after a rejected settlement. *See, e.g., Ford Motor Co. Bronco II Product Liability Litig.*, 177 F.R.D. at 376 (following rejection of a proposed class settlement, court considered class requirements and held that "only individualized adjudications of the merits of plaintiffs' individual claims can provide a fair and efficient process").

Defendants, of course, provide great assistance to courts in this regard because, outside the settlement context, they are the one party in court with the incentive and ability to raise concerns about the propriety of certification. But the Seventh Circuit's estoppel rule will deprive courts of that assistance whenever there has been a settlement that was previously rejected. Indeed, the rule presupposes that there is a potentially meritorious objection to certification – since that is the only situation in which the estoppel makes a difference – but prohibits the objection from being raised by the one party in court who might do so. As this discussion illustrates, it makes no sense to apply the doctrine of judicial estoppel to bar discussion of an issue that the court has an independent duty to consider and address throughout the case.

B. Waiver

The Seventh Circuit's waiver ruling with regard to the collateral estoppel defense was just as dubious in principle and will further deter defendants from attempting to settle class cases. The Seventh Circuit made up out of whole cloth the notion that a defendant must raise every conceivable defense it may have during the proceedings where a class settlement is being considered by the court, or risk being barred on waiver grounds from asserting that defense later after the settlement is rejected. Here, the particular defense

at issue was a collateral estoppel argument against certification of the class based on the rejection of much the same class in a prior federal case in Georgia. But the Seventh Circuit's new waiver rule is not so limited. It will effectively require every settling defendant to produce a listing of all the potential defenses it has, during the settlement proceedings, in order to preserve those defenses for later in the case if necessary.

The logic of such a rule is difficult to discern. Defendants already have an incentive to point to the weaknesses in the plaintiffs' case in order to convince the court to accept the settlement. But there is no apparent reason why they should be required to list all of their potential arguments at that stage or risk losing them. Certainly the Seventh Circuit offered no explanation or even a citation to pertinent authority.

The primary effect of such a senseless rule can only be to create another potential trap for settling defendants – one more reason to avoid settling and simply litigate the case. From now on, at least in the Seventh Circuit, they will know that by settling they not only are conceding most of the arguments against class certification but also are risking losing any other defense that does not come to mind and get disclosed during the settlement proceedings.

CONCLUSION

For these reasons, the writ of certiorari should be granted.

Respectfully submitted,

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October 14, 2004

APPENDICES

APPENDIX A

LYNNE A. CARNEGIE, on behalf of herself and all others similarly situated, Plaintiff-Appellee,
v.
HOUSEHOLD INTERNATIONAL, INC., et al., Defendants-Appellants.

Nos. 04-8008, 04-8009

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

376 F.3d 656; 2004 U.S. App. LEXIS 14635

May 15, 2004, Submitted
July 16, 2004, Decided

Before CUDAHY, POSNER, and ROVNER, Circuit Judges.

POSNER, *Circuit Judge*. We have consolidated for decision petitions, by two groups of defendants in a consumer-finance class action litigation, for leave to appeal an order by the district court certifying a plaintiff class. Fed. R. Civ. P. 23(f) authorizes us to entertain such interlocutory appeals. The rule does not state criteria for the exercise of this discretionary authority. But the case law teaches that the more novel the issue presented by the appeal and so the less likely that the district court's resolution of it will stand, the more important the resolution of the issue is either to the particular litigation or to the general development of class action law, and the more likely the prompt resolution of the issue is to expedite the litigation and prevent a coercive

settlement, the stronger the case for allowing the appeal. *E.g.*, *In re Bridgestone/Firestone, Inc.*, 288 F.3d 1012, 1016 (7th Cir. 2002); *Blair v. Equifax Check Services, Inc.*, 181 F.3d 832, 834-35 (7th Cir. 1999); *Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154, 164 (3d Cir. 2001); *Prado-Steiman v. Bush*, 221 F.3d 1266, 1278 (11th Cir. 2000); *Waste Management Holdings, Inc. v. Mowbray*, 208 F.3d 288, 294 (1st Cir. 2000). The issues that the petitions ask us to consider, in the setting of a class of millions, concern, first, the procedures and criteria for converting a settlement class into a litigation class when having initially been approved the settlement is later disapproved, and, second, the bearing of the doctrine of judicial estoppel on class action litigation. These are novel issues whose prompt resolution is important to the development of the law of class actions as well as to the resolution of the present case. The petitions to appeal are therefore granted. The merits of the appeals have been fully briefed and we can therefore proceed to decide them without requiring further briefing.

The litigation arose out of refund anticipation loans made jointly by the defendants, who for simplicity we'll refer to as "the bank" and "the tax preparer." When the tax preparer files a refund claim with the Internal Revenue Service on behalf of one of its customers, the customer can expect to receive the refund within a few weeks unless the IRS decides to investigate the return. Even a few weeks is too long for the most necessitous taxpayers, and so the bank will lend the customer the amount of the refund for the period between the filing of the claim and the receipt of the refund. The annual interest rate on such a "refund anticipation loan" (RAL) will often exceed 100 percent. Although the bank is the lender, the tax preparer arranges the loan. It is contended that the customer is told neither that the bank pays the tax preparer a

fee for having generated the loan nor that the tax preparer receives an ownership interest in the loan.

Beginning in 1990 a number of class-action suits were brought against the defendants on behalf of a total of 17 million refund-anticipation borrowers, charging violations of various state and federal laws, including RICO. The basic claim is that the defendants lead the borrowers to believe that the tax preparer is their fiduciary, much as if they had hired a lawyer or an accountant to prepare their income tax returns, as affluent people do, whereas, unbeknownst to them, the tax preparer is engaged in self-dealing. This conduct is alleged to constitute a scheme to defraud in violation of the federal mail- and wire-fraud statutes. Violations of those statutes are "predicate offenses" that can form the basis of a RICO charge.

In 1999 the named plaintiff in one of the suits entered into a settlement agreement with the bank and the tax preparer. This was to be a "global" settlement: the members of all the classes would divide up a $ 25 million fund put up by the defendants in exchange for the release of all claims arising out of the RALs. The district judge approved the settlement and enjoined (with one exception) the other RAL class actions, *Zawikowski v. Beneficial National Bank*, 2000 U.S. Dist. LEXIS 11535, No. 98 C 2178, 2000 WL 1051879 (N.D. Ill. July 28, 2000), but we reversed, *Reynolds v. Benefit National Bank*, 288 F.3d 277 (7th Cir. 2002), on the ground that the district judge had failed to scrutinize the fairness of the settlement adequately. We were concerned that the settlement might have been the product of collusion between the defendants, eager to minimize their liability, and the class lawyers, eager to maximize their fees.

The district judge to whom the case was reassigned on remand concluded that the settlement had indeed been unfair and disapproved it. 260 F. Supp. 2d 680 (N.D. Ill. 2003).

There was no appeal. The proceedings continued in the district court, with both the named plaintiff and the class counsel replaced. Although no class had formally been certified in the earlier proceedings, rather than require the new plaintiff to move for certification the judge asked the defendants for their objections to certification, and they responded. She agreed with some of the objections, rejected others, and, in effect, certified the same class that had been contemplated by the rejected settlement, which is to say all RAL borrowers (with a few exceptions) whose claims weren't barred by the statute of limitations. But she limited the certification to prosecution of just the RICO claim, plus one breach of contract claim involving the law of only one state.

The defendants object mainly to the procedure the judge employed and to the brevity with which she pronounced the class manageable despite its vast size. In the previous round of this protracted litigation the defendants had urged the district court to accept the giant class as appropriate for a global settlement, had prevailed in their urging, and so are now precluded by the doctrine of judicial estoppel, *see, e.g., New Hampshire v. Maine*, 532 U.S. 742, 121 S. Ct. 1808, 149 L. Ed. 2d 968 (2001), from challenging its adequacy, at least as a settlement class (the significance of this qualification will appear in due course). It is true that we reversed the district court's approval of the settlement, but a reversal need not affect the application of judicial estoppel. *In re Cassidy,* 892 F.2d 637, 641 (7th Cir. 1990); *Hall v. GE Plastic Pacific PTE Ltd.*, 327 F.3d 391, 398-99 (5th Cir. 2003); *U.S. Philips Corp. v. Sears Roebuck & Co.*, 55 F.3d 592, 597 (Fed. Cir. 1995); *cf.* 18B Charles Alan Wright, Arthur R. Miller & Edward H. Cooper, *Federal Practice and Procedure* § 4477 (2d ed. 2002). The reason lies in the purpose of the doctrine. The canonical statement of that purpose is that it is "to protect the integrity of the judicial

process." *E.g., New Hampshire v. Maine, supra,* 532 U.S. at 749-50; *United States v. Christian,* 342 F.3d 744, 747 (7th Cir. 2003). But we have been a little more precise. We have said that "a party who prevails on one ground in a lawsuit cannot turn around and in another lawsuit repudiate the ground. If repudiation were permitted, the incentive to commit perjury and engage in other litigation fraud would be greater. A party envisaging a succession of suits in which a change in position would be advantageous would have an incentive to falsify the evidence in one of the cases, since it would be difficult otherwise to maintain inconsistent positions." *McNamara v. City of Chicago,* 138 F.3d 1219, 1225 (7th Cir. 1998) (citations omitted). In other words, "the purpose of the doctrine . . . is to reduce fraud in the legal process by forcing a modicum of consistency on a repeating litigant." *Ladd v. ITT Corp.,* 148 F.3d 753, 756 (7th Cir. 1998); *see also Bethesda Lutheran Homes & Services, Inc. v. Born,* 238 F.3d 853, 858 (7th Cir. 2001).

The antifraud policy that animates the doctrine is fully engaged when a party obtains a judgment on a ground that it later repudiates, even if his opponent, the loser in that first case, is able, obviously at some expense to itself but also placing a demand on judicial resources, to get the judgment reversed. Anyway the defendants benefited from the temporary approval of the settlement, which they used to enjoin other RAL litigation against them; and having reaped a benefit from their pertinacious defense of the class treatment of the case for purposes of settlement they cannot now be permitted to seek a further benefit from reversing their position.

It is true that we went on to say in *McNamara* that "the doctrine of judicial estoppel requires . . . that the party sought to be estopped have obtained a favorable judgment or settlement on the basis of a legal or factual contention that he

wants to repudiate in the current litigation. Otherwise it would be inconsistent with the rule that permits inconsistent pleadings." 138 F.3d at 1225. But the defendants did obtain a judgment. The fact that it was reversed on appeal has nothing to do with a party's right to explore inconsistent alternative positions in the early stages of a lawsuit.

The defendants are correct, however, that a class might be suitable for settlement but not for litigation. The class might be unmanageable if the case were actually tried yet manageable as a settlement class because the settlement might eliminate all the thorny issues that the court would have to resolve if the parties fought out the case. *Amchem Products, Inc. v. Windsor,* 521 U.S. 591, 620, 117 S. Ct. 2231, 138 L. Ed. 2d 689 (1997). But although the district judge might have said more about manageability, the defendants have said nothing against it except that there are millions of class members. That is no argument at all. The more claimants there are, the more likely a class action is to yield substantial economies in litigation. It would hardly be an improvement to have in lieu of this single class action 17 million suits each seeking damages of $ 15 to $ 30. The rejected settlement capped damages at these amounts for single and multiple RALs respectively, and while the amounts may be too low they are indicative of the modest stakes of the individual class members. The *realistic* alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for $ 30. But a class action has to be unwieldy indeed before it can be pronounced an inferior alternative--no matter how massive the fraud or other wrongdoing that will go unpunished if class treatment is denied--to no litigation at all.

Often, and possibly in this case as well, there is a big difference from the standpoint of manageability between the liability and remedy phases of a class action. The number of

class members need have no bearing on the burdensomeness of litigating a violation of RICO. Whether particular members of the class were defrauded and if so what their damages were are another matter, and it may be that if and when the defendants are determined to have violated the law separate proceedings of some character will be required to determine the entitlements of the individual class members to relief. Fed. R. Civ. P. 23(c)(4)(A); *Allen v. International Truck & Engine Corp.*, 358 F.3d 469 (7th Cir. 2004); *Bell Atlantic Corp. v. AT&T Corp.*, 339 F.3d 294, 307 n.16 (5th Cir. 2003); *In re Visa Check/MasterMoney Antitrust Litigation*, 280 F.3d 124, 141 (2d Cir. 2001); *Robinson v. Metro-North Commuter R.R.*, 267 F.3d 147, 168-69 (2d Cir. 2001). That prospect need not defeat class treatment of the question whether the defendants violated RICO. Once that question is answered, if it is answered in favor of the class, a global settlement along the lines originally negotiated (though presumably with different dollar figures) will be a natural and appropriate sequel. And if there is no settlement, that won't be the end of the world. *Rule 23* allows district courts to devise imaginative solutions to problems created by the presence in a class action litigation of individual damages issues. Those solutions include "(1) bifurcating liability and damage trials with the same or different juries; (2) appointing a magistrate judge or special master to preside over individual damages proceedings; (3) decertifying the class after the liability trial and providing notice to class members concerning how they may proceed to prove damages; (4) creating subclasses; or (5) altering or amending the class." *In re Visa Check/MasterMoney Antitrust Litigation, supra*, 280 F.3d at 141.

We did note in our previous decision an unremarked conflict of interest between those class members who took out one or two refund anticipation loans and those who took out more than two and would thus, because of the $ 30 cap

that we just mentioned, receive no compensation for the additional harm that they suffered. 288 F.3d at 282. But we went on to say that "in light of the modesty of the stakes even of class members who had multiple refund anticipation loans and the expense of subdividing the class (and how many subdivisions would be necessary to reflect the full range of damages?), we are not disposed to regard this particular defect in the settlement as fatal."

The defendants argue that by requiring them to present their objections to class certification rather than requiring the plaintiff to move for certification, the district judge improperly altered the burden of proof on the question whether the class should be certified. Not so. Although the plaintiff class had not formally been certified in the earlier proceedings, that was indeed a formal defect--a technical oversight that was surprising but from a practical standpoint inconsequential. The case had been settled as a class action, notices had been sent, objections had been considered and rejected--all on the assumption that a class had been certified. This was de facto certification, albeit of a settlement class only, and that was enough, we think, to empower Judge Bucklo, in the exercise of her discretion to manage litigation before her in an efficient and expeditious manner, to require the defendants to list their objections to the certification of a litigation class, especially since she was explicit that the burden of persuasion on the validity of the objections would remain on the plaintiffs. They carried the burden easily. Remember that the defendants themselves had argued that the class was appropriate for settlement purposes. That did not conclude the question whether it was appropriate for litigation if the settlement fell through, as we have explained and as the district judge recognized. But it was some indication that there were issues appropriate for determination on a class basis.

The defendants argue that the named plaintiff has not been shown to be an adequate representative of the class, but the district judge thought otherwise on sufficient grounds. The defendants also argue that class certification is barred by collateral estoppel, and this argument requires a fuller discussion.

In re Bridgestone/Firestone, Inc., Tires Products Liability Litigation, 333 F.3d 763 (7th Cir. 2003), holds that a judicial finding that a class should not be certified is, at least in some circumstances, entitled to collateral estoppel effect--and in *Buford v. H&R Block, Inc.*, 168 F.R.D. 340 (S.D. Ga. 1996), *aff'd*, 117 F.3d 1433 (11th Cir. 1997) (*per curiam*), a federal district judge refused to certify a nationwide class action charging, just as in this case, that our defendants' practices with respect to RALs violated RICO. The judge recognized that the question whether RICO was violated was separate from the question whether the targets of the violation had been injured by the violation. 18 U.S.C. § 1964(c); *Holmes v. Securities Investor Protection Corp.*, 503 U.S. 258, 267-68, 112 S. Ct. 1311, 117 L. Ed. 2d 532 (1992). The predicate acts in the RICO claim are violations of the mail- and wire-fraud statutes, and these statutes are violated by a "scheme or artifice to defraud," 18 U.S.C. §§ 1341, 1343, whether or not the scheme succeeds and therefore causes injury. *E.g.*, *United States v. Tadros*, 310 F.3d 999, 1006 (7th Cir. 2002); *United States v. Coffman*, 94 F.3d 330, 333-34 (7th Cir. 1996); *United States v. Daniel*, 329 F.3d 480, 486 (6th Cir. 2003). The separation of liability and injury issues is illustrated by the suggestion in *Moore v. PaineWebber, Inc.*, 306 F.3d 1247, 1255-56 (2d Cir. 2002), that in a suit charging "uniform misrepresentations" the question whether they were indeed misrepresentations would be appropriate for class treatment, with the question of reliance, and damages suffered, by individual class members left for satellite proceedings. *See also In re Prudential Ins. Co. of*

America Sales Practice Litigation, 148 F.3d 283 (3d Cir. 1998).

The judge in *Buford* thought, however, that the issue of violation would be swamped by issues concerning whether the borrowers had been deceived--had relied on the fraud, and thus had been injured, whether directly, as in *American Chiropractic Ass'n, Inc. v. Trigon Healthcare Inc.*, 367 F.3d 212, 233 (4th Cir. 2004); *Bank of China v. NBM LLC,* 359 F.3d 171, 178 (2d Cir. 2004); *Byrne v. Nezhat,* 261 F.3d 1075, 1109-10 (11th Cir. 2001), and *Summit Properties Inc. v. Hoechst Celanese Corp.*, 214 F.3d 556 (5th Cir. 2000), or perhaps, as in *Systems Management, Inc. v. Loiselle,* 303 F.3d 100, 104 (1st Cir. 2002), indirectly. Those issues would have to be resolved separately for each class member. In deciding that therefore the case was inappropriate for class treatment, the judge was applying the presumption against class action certification in RICO cases that has been articulated by the Fifth Circuit in *Sandwich Chef of Texas, Inc. v. Reliance Nat'l Indemnity Ins. Co.,* 319 F.3d 205, 219 (5th Cir. 2003). We are dubious about such a presumption. The question whether RICO was violated can be separated from the question whether particular intended victims were injured, and thus can--or so a district court could determine without being thought to have abused its discretion--be resolved in a single proceeding with the issue of injury parceled out to satellite proceedings, as is frequently done in class action tort litigation, *see, e.g., Exxon Co. v. Sofec, Inc.,* 54 F.3d 570, 575-76 (9th Cir. 1995); *In re Bendectin Litigation,* 857 F.2d 290, 308-13 (6th Cir. 1988), of which the RAL class litigation is a species.

The adequacy of the judge's reasoning in *Buford* is not important, however, if, as the defendants contend, his ruling is entitled to collateral estoppel effect. But they overread *Bridgestone/Firestone* to hold that *any* ruling denying class

certification is binding in future litigation. Our decision was more nuanced. See 333 F.3d at 767-69. For example, we pointed out that the binding effect of such a ruling would depend on whether the class members who would be affected by it had been adequately protected by the class representatives and class counsel in the proceeding in which the ruling was made. The judge in *Buford* discussed the issue of adequacy at some length, however, 168 F.R.D. at 352-55, and we are not disposed to reexamine his ruling. But it is too late for the defendants to plead collateral estoppel when, though knowing of the *Buford* decision, which was issued in 1996 and affirmed the following year, they insisted until last year, when the district court on remand from our decision threw out the settlement, that class treatment of the RICO claim was entirely appropriate. Until then they desperately wanted the RICO claim included in the class settlement so that they wouldn't have to face it in any other RAL suits. They prevailed in the present litigation, until the settlement was finally rejected, by arguing that *Buford* was wrong. They are estopped to argue now that it was right. And anyway collateral estoppel is an affirmative defense that is forfeited if not raised in timely manner, and it was not raised in a timely manner in this case.

The defendants tell us that anything that makes it easier for a settlement class to molt into a litigation class will discourage the settlement of class actions. They say that defendants have settled class actions "in the past secure in the knowledge that if the settlement agreement should unravel, they would be restored to the pre-certification position and remain free to defend against any future effort to certify a class for litigation purposes." But the defendants in this case were perfectly free to defend against certification; they just didn't put up a persuasive defense. Anyway their argument is unrealistic. The pressures for settlement of class actions

are enormous and will not be lessened significantly by our upholding the class certification.

We are mindful that no district judge has as yet explicitly addressed whether the other criteria for class certification, besides adequacy of representation of the class, have been met in this case. Those criteria are whether "(1) the class is so numerous that joinder of all members is impracticable; (2) there are questions of law or fact common to the class; (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class." Fed. R. Civ. P. 23(a). There is no need for a remand on these questions, however. Criteria (1) and (2) have been met; and the satisfaction of (3) is implicit in Judge Bucklo's rejection of the defendants' contention that to handle their dispute with the class members in the class action format would be unmanageable. There has been substantial compliance with the requirements of the rule, and no more is required, *Shvartsman v. Apfel,* 138 F.3d 1196, 1201 (7th Cir. 1998); *Berger v. Iron Workers Reinforced Rodmen Local 201*, 269 U.S. App. D.C. 67, 843 F.2d 1395, 1401 (D.C. Cir. 1988), especially in a case in which the defendants were enthusiastic proponents of class treatment until their opportunistic change of heart.

AFFIRMED.

APPENDIX B

LYNNE A. CARNEGIE, on behalf of herself and all others similarly situated, Plaintiff,

v.

HOUSEHOLD INTERNATIONAL, INC., HOUSEHOLD BANK, f.s.b., successor in interest to BENEFICIAL NATIONAL BANK, HOUSEHOLD TAX MASTERS INC., formerly known as BENEFICIAL TAX MASTERS INC., BENEFICIAL FRANCHISE COMPANY, INC., H&R BLOCK, INC., H&R BLOCK SERVICES, INC., H&R BLOCK EASTERN TAX SERVICES, INC., BLOCK FINANCIAL CORP., and HRB ROYALTY, INC., Defendants.

No. 98 C 2178

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

220 F.R.D. 542; 2004 U.S. Dist. LEXIS 5284

March 29, 2004, Decided

March 30, 2004, Docketed

Elaine E. Bucklo, United States District Judge.

MEMORANDUM OPINION AND ORDER

In 1995, plaintiff Lynne A. Carnegie, a citizen of New York, responded to an advertisement and patronized an H&R Block store in New York. She purchased a refund anticipation loan ("RAL") and paid charges of $ 110 on a nine-day loan of $ 500. Ms. Carnegie alleges that she was

duped into buying the RAL through a complex and illegal scheme involving various arms of H&R Block (collectively, "Block") and arms of its co-conspirator bank (collectively "Beneficial"). In brief, the scheme alleged is as follows. Block runs a tax preparation and advising service with numerous branches throughout the country. Block also performs electronic filing of tax returns, which greatly speeds up the arrival of patrons' refund checks. Block made a bargain with Beneficial whereby Block would advertise and sell Beneficial's RALs to its customers. Block provided its customers with the loan documentation and even printed the check, but the funds came from Beneficial, and the obligation to repay via refund check was likewise to Beneficial. Block received a payment from Beneficial for each RAL customer it recruited.

This case, then titled *Zawikowski v. Beneficial, Reynolds v. Beneficial,* and *Turner v. Beneficial,* reached settlement. That settlement was approved by Judge Zagel, but remanded by the Seventh Circuit for further consideration. *Reynolds v. Beneficial Nat'l Bank,* 288 F.3d 277 (7th Cir. 2002). I subsequently rejected the settlement and required that new counsel represent the class. *Reynolds v. Beneficial Nat'l Bank,* 260 F. Supp. 2d 680 (N.D. Ill. 2003). New counsel (objectors to the earlier settlement) filed a second amended complaint in which they substituted Ms. Carnegie as the only named plaintiff. The defendants now move to dismiss that complaint. The parties have also addressed class certification issues, with the defendants arguing that the class should be decertified.

On a motion to dismiss, I accept as true all well-pleaded facts in the complaint, and grant the motion only if the plaintiff can prove no set of facts to support his claim. *Strasburger v. Bd. of Educ.,* 143 F.3d 351, 359 (7th Cir.

1998).[1] I deny the motion to dismiss Count II as to the racketeering and conspiracy provisions of RICO, but grant it as to the investment injury and enterprise control provisions. The motion to dismiss Counts III, IV, V, and VIII (consumer fraud, breach of fiduciary duty, subornation of breach of fiduciary duty, and unjust enrichment) is denied as moot; I withdraw certification of the class as to those claims. The motion to dismiss Counts VI and VII (breach of contract) is granted as to Block. I deny the motion to dismiss Count VI as to Beneficial. The motion to dismiss Count VII as to Beneficial is denied as moot; the plaintiff has voluntarily withdrawn that count.

I.

The defendants move to dismiss Count II, which alleges violations of four different provisions of the Racketeer Influenced and Corrupt Organizations act ("RICO"), 18 U.S.C. §§ 1961, 1962(a)-(d), *et seq.* (addressing investment injury, enterprise control, racketeering, and conspiracy, respectively). The defendants argue that this count fails to state a claim for numerous reasons, including lack of Fed. R. Civ. P. 9(b) particularity, failure to allege a RICO enterprise, failure to plead an investment injury, failure to plead an injury stemming from the defendants' acquisition or control of an enterprise, failure to plead that each defendant conducted the affairs of the enterprise, failure to allege conspiracy, and failure to comply with the statute of limitations. Ms. Carnegie responds that each of these arguments either has no merit or is barred from consideration by judicial estoppel because Judge Zagel denied a motion to dismiss RICO claims earlier in the case. I find that the complaint adequately states a claim against all defendants under the racketeering and conspiracy provisions of RICO,

[1] In separate orders, I have dismissed Count I, alleging violations of the federal Truth in Lending Act ("TILA"), as to all of the defendants.

but not under the investment injury or enterprise control provisions.[2]

The law of the case doctrine bars reconsideration of Judge Zagel's ruling in *Turner v. Beneficial,* No. 98 C 2550 (Mar. 30, 1999), which held that the plaintiff class adequately alleged a RICO enterprise, stated a claim under § 1962(c), the racketeering provision of RICO, and satisfied the heightened pleading requirements of Fed. R. Civ. P. 9(b). *See Parts & Elec. Motors, Inc. v. Sterling Elec., Inc.,* 866 F.2d 228 (7th Cir. 1988) (prior decisions in a case should not be overruled unless they strike the reviewing court as wrong "with the force of a five-week-old, unrefrigerated dead fish"). Although the named plaintiff in this case has changed since the time of that ruling, the plaintiff class and the central allegations of the claim have not. The Beneficial defendants are bound by that ruling. However, Block had been dismissed from this case at the time of Judge Zagel's ruling, and the RICO claim against Block must be evaluated on its merits.

Block argues that Count II fails to comply with the heightened pleading requirement of Fed. R. Civ. P. 9(b). The predicate acts that form the basis of Ms. Carnegie's RICO claim are acts of consumer fraud, and thus must be pleaded with particularity. This requirement 138 L. Ed. 2d 689, must be relaxed where the plaintiff lacks access to all facts necessary to detail his claim," *Corley v. Rosewood Care Ctr.,* 142 F.3d 1041, 1051 (7th Cir. 1998). This case is unique in that not only has it been ongoing for over five years, but one of Block's counsel participated in drafting a previous

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[2] Block makes a perfunctory argument that Carnegie's RICO action is time-barred. She received her RAL in February, 1995. This action was filed in 1998, well within the four-year statute of limitations. The fact that Carnegie was not then the named class representative is irrelevant.

complaint alleging violations of RICO. Under the circumstances of this case, Rule 9(b) is satisfied.

Turning to the other issues raised in the motion to dismiss, Block argues that Ms. Carnegie failed to allege a RICO enterprise, an element of her claim under § 1962(c). That provision addresses injuries to the plaintiff resulting directly from the defendants' predicate acts. *See Peterson v. H & R Block Tax Servs., Inc.*, 22 F. Supp. 2d 795, 802 (N.D. Ill. 1998) (in order to state a *§ 1962* claim, the plaintiff must allege that the defendants "(1) conducted (2) an enterprise through (3) a pattern (4) of racketeering activity"). A RICO enterprise is "a group of persons associated together for a common purpose of engaging in a course of conduct." *United States v. Turkette*, 452 U.S. 576, 583, 101 S. Ct. 2524, 69 L. Ed. 2d 246 (1981). An enterprise is shown by "evidence of an ongoing organization, formal or informal, and by evidence that the various associates function as a continuing unit." *Id.* An enterprise must be more than simply a group of people who get together to commit crimes, or a group of associated businesses operated in concert; it must have structure and continuity, as well as "differentiation of the roles within it." *Richmond v. Nationwide Cassel L.P.*, 52 F.3d 640, 645. However, an enterprise need not have the complexity of a corporation. "There must be some structure, to distinguish an enterprise from a mere conspiracy, but there need not be much." *Burdett v. Miller*, 957 F.2d 1375, 1379 (7th Cir. 1992).

This is exactly what Ms. Carnegie alleges. The complaint states that the Block defendants and the Beneficial defendants operated a scheme to defraud customers, distinct from the other ordinary business dealings each conducted, whereby Block would attract and mislead consumers into purchasing extremely expensive loans from Beneficial in exchange for a cut of the profits. The defendants' argument

that mere contractual relations between entities cannot create a RICO enterprise is accurate, but misplaced. Ms. Carnegie does not rely solely on the contractual relationship between the parties to support her RICO claim. Rather, the contractual relationship is simply one fact among many which together constitute an adequate allegation of a RICO enterprise.

The Block defendants argue that Ms. Carnegie failed to adequately allege that each defendant conducted the affairs of the enterprise, an additional element crucial to a 1962(c) claim. *Goren,* 156 F.3d 721, 727. They base this argument on the fact that the complaint does not distinguish among the Block defendants, who are alleged to have operated the enterprise. This argument is unpersuasive. At the pleading stage, prior to discovery, a plaintiff cannot be expected to determine which of the various Block entities was in control of which aspects of the enterprise. It is sufficient to plead the acts complained of and attribute them to "H & R Block," even if the plaintiff does not know whether "H & R Block, Incorporated" or "H & R Block Services, Incorporated" was the entity technically in charge of the disputed transaction. Block cannot evade liability by hiding behind its multi-faced corporate identity.

Next, defendants argue that Ms. Carnegie has failed to plead an investment injury, an element of her claim under § 1962(a). This section covers injuries which are caused by the use or investment of racketeering income. Although the Seventh Circuit has yet to make a definitive ruling on the question, "the majority of circuits hold that the use or investment of the racketeering income must proximately cause the plaintiff's injury; injury caused by the predicate racketeering acts is inadequate." *Vicom, Inc. v. Harbridge Merch. Servs., Inc.,* 20 F.3d 771, 779, n.6 (7th Cir. 1994). Since *Vicom,* "each court in this district addressing the issue has adopted the majority use or investment rule." *Shapo v.*

O'Shaughnessy, 246 F. Supp. 2d 935, 965 (N.D. Ill. 2002) (collecting cases). I agree with my colleagues that this interpretation is most faithful to the plain wording of the statute. *See, e.g., Rose v. Mony Life Ins. Co.,* 82 F. Supp. 2d 920, 923 (N.D. Ill. 2000). Thus, in order to state a claim under § 1962(a), Ms. Carnegie must allege an investment injury which can be distinguished from the injuries resulting from the predicate acts of fraud. *Id.* The complaint does not meet this standard. Ms. Carnegie alleges that the defendants used racketeering income "to acquire an interest in, establish, or operate the RAL enterprise . . . which has caused injury to plaintiff." 2d Am. Compl. at 217. In other words, it is the enterprise, not the investment, which caused the alleged injury. The motion to dismiss is granted as to the alleged violations of § 1962(a).

The defendants argue next that Ms. Carnegie has failed adequately to plead injury stemming from enterprise control. Like § 1962(a), a claim relying on § 1962(b) must allege that the plaintiff's injury resulted from the defendants' acquisition or control of the RICO enterprise, rather than from the predicate acts. *Midwest Grinding Co., Inc. v. Spitz,* 716 F. Supp. 1087, 1091 (N.D. Ill. 1989) (comparing § 1962(a) and § 1962(b) and concluding that the same standard applies to both); *Roger Whitmore's Auto. Servs., Inc. v. Lake County,* No 99-C2504, 2002 U.S. Dist. LEXIS 8289, at *30 (N.D. Ill. May 9, 2002) (citing *Midwest Grinding*). Here, Ms. Carnegie does not allege separate injury proximately caused by the defendants' ownership of the enterprise; the complaint states only that the defendants owned the enterprise and the enterprise harmed the plaintiffs. 2d Am. Compl. at 218. The motion to dismiss is granted as to the alleged violations of § 1962(b).

Finally, the defendants contend that Ms. Carnegie fails to plead a conspiracy under § 1962(d). That section covers

conspiracy to violate provisions (a), (b), or (c) of § 1962. The defendants argue that the language in Count II is merely a "naked and insufficient legal conclusion" and does not satisfy the standard. While it is true that Count II itself does not contain detailed allegations, it incorporates the preceding paragraphs in the body of the complaint, which contain numerous explicit statements spelling out the who, what, and when of the alleged agreement between the Block defendants and the Beneficial defendants. 2d Am. Compl. at 47-64. These allegations, taken in sum, are more than enough to state a claim for conspiracy under § 1962(d).

The defendants argue for decertification of the plaintiff class as to the RICO count on the basis of *In the Matter of Bridgestone/Firestone, Inc.*, 333 F.3d 763 (7th Cir. 2003). Because a court in 1996 had refused to certify a RICO class alleging similar claims against some of the defendants in this case, defendants say the class claims here are barred by collateral estoppel under *Bridgestone/Firestone. Buford v. H&R Block*, 168 F.R.D. 340, 364 (S.D. Ga. 1996), *aff'd*, 117 F.3d 1433 (11th Cir. 1997). Defendants did not raise this argument in either the Seventh Circuit or this court at the time they were arguing for approval of the prior settlement.[3] Obviously, if the alternative to settlement was no class at all, the settlement would indeed be fair. Defendants have waived this defense by failing to raise it when the Seventh Circuit and this court were considering whether the settlement should be approved. In addition, defendants obtained definite benefits from the class certification in this case. During the period after approval of the class and settlement by the district court in 1999 and the time I rejected the

[3] This is in contrast to the statute of limitations, which defendants consistently raised as a potential bar to some claims if the settlement was not approved.

settlement in 2003, defendants were able to enjoin numerous other actions on the basis of the class settlement. While those injunctions were ultimately vacated, defendants do not even argue that they obtained no benefit from the injunctions.

II.

The defendants move to dismiss Counts VI and VII, which allege two breach-of-contract theories against both sets of defendants. The parties agree that the Delaware choice-of-law provision in the RAL documents governs claims for breach of those documents.

Judge Zagel has already twice denied motions to dismiss breach of contract claims against Beneficial substantially similar to Count VI. *Zawikowski v. Beneficial Nat'l Bank,* No. 98-C2178, 1999 U.S. Dist. LEXIS 514, at *11 (N.D. Ill. Jan. 11, 1999); *Turner,* No. 98-C2550 (Mar. 30, 1999). These rulings are the law of the case, and I will not revisit them now. Count VI against Beneficial withstands the motion to dismiss. Carnegie concedes that the actions complained of in Count VII were not barred by the agreement, and thus voluntarily withdraws Count VII as to Beneficial. Pl. Opp. to Ben. Def.'s Mot. to Dismiss, at 14.

Block argues that Ms. Carnegie cannot sustain a claim against it for breach of contract, as it was not a party to any RAL contract. In her opposition to the Block defendants' motion to dismiss, Carnegie relies on the following language to support her position that Block entered into a unilateral contract with its RAL customers:

> I hereby authorize and request H&R Block and its affiliates to disclose to Beneficial National Bank and its agents ("BNB") my federal income tax return for tax year 1994, any and all other information contained in such tax return, all information supplied to H&R Block, including IRS

> direct deposit information, in connection with the preparation of such tax return, and all other information contained in this form and any information contained in any of my prior RAL applications which was disclosed to H&R Block. I authorize and consent to the disclosure of the foregoing information for the purpose of enabling BNB to determine whether or not to make a Refund Anticipation Loan ("RAL") to me in response to any application for such loan which is a part of this form . . . H&R Block may not use or disclose such tax return information for any purpose . . . other than as stated herein."

Pl.'s Corr. Opp. to Block Def. Mot. to Dismiss, at 14-15. The quoted language describes no obligation on Block's part whatsoever. According to this document, Block is authorized to reveal information under certain circumstances, but Block makes no promise, or even offer, to do so. I cannot see how Block can be in breach of an agreement wherein it did not promise to do anything. Ms. Carnegie cites to three Delaware cases which allegedly support the notion that this language could constitute a binding contract enforceable against Block, but none comes close to holding that authorizations like the quoted language can constitute an enforceable contract.[4]

I grant the motion to dismiss Counts VI and VII as to Block. I deny the motion to dismiss Count VI as to

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[4] *Cont'l Ins. Co. v. Rutledge & Co.*, 750 A.2d 1219 (Del. Ch. 2000) is entirely inapposite; it concerns oral modifications of a partnership agreement. *Kysor Indus. Corp. v. Margaux, Inc.*, 674 A.2d 889 (Del. Super. Ct. 1996) enforced a unilateral contract against a party who had promised to pay a certain sum upon the occurrence of a triggering event. *Abbott v. Stephany Poultry Co.*, 44 Del. 513, 5 Terry 513, 62 A.2d 243 (De. Super. Ct. 1948) states that partial performance by a promisee may bind the promisor. None of these cases suggests that a non-promisor such as Block may be bound.

Beneficial. The motion to dismiss Count VII as to Beneficial is denied as moot, as that count has been voluntarily withdrawn.

III.

The defendants move to dismiss Counts III, IV, V, and VIII on a number of grounds. I find that the multi-state legal analysis which would be required to resolve each of these claims presents an intractable class certification problem.[5]

The Seventh Circuit's prior acceptance of the certifiability of the class, discussed above, is binding on every point except the adequacy of the new named plaintiff (discussed in Section VI, below), adequacy of counsel and manageability, which is analyzed differently for settlement classes and litigation classes. "Confronted with a request for settlement-only class certification, a district court need not inquire whether the case, if tried, would present intractable management problems." *Amchem Prods. Inc. v. Windsor*, 521 U.S. 591, 620, 117 S. Ct. 2231, 138 L. Ed. 2d 689 (1997). Where litigation classes are concerned, however, courts must give the manageability issue a "close look." *Id.* at 615-16. While all claims here present a management challenge simply due to the size of the class, the difficulties presented by the federal claims are surmountable. However, the four state-law claims discussed here present such unwieldy issues that a nationwide class action cannot be the most efficient method of resolving them.

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[5] When I refer to "state-law claims," I am referring to these four counts. While Counts VI and VII for breach of contract are also based in state law, they are subject to the Delaware choice-of-law clause in the RAL agreement, and thus do not present the manageability problems of Counts III, IV, V, and VIII.

In her briefs, Ms. Carnegie makes conflicting arguments as to what law will apply to the four claims, arguing at various points for the law of Illinois, Delaware, and federal common law. None of arguments are persuasive. When deciding pendent claims based in state law, federal district courts apply the choice-of-law rules of the state where they sit. *Klaxon v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 61 S. Ct. 1020, 85 L. Ed. 1477 (1941). Illinois' choice-of-law doctrine applies the law of the state which has the most significant contacts with the dispute. *Ingersoll v. Klein,* 46 Ill. 2d 42, 262 N.E.2d 593 (Ill. 1970). As the class members apparently reside in all fifty states, negotiated and entered into RAL agreements in all fifty states, and were allegedly injured in all fifty states, it cannot be that any one state had the most significant contacts with all those millions of disputes. This dispute's contacts with states of the defendants' incorporation or the forum state will not outweigh the much stronger contacts each RAL transaction had with the state where it was negotiated and entered into and where the class member was allegedly injured. *See In the Matter of Rhone-Poulenc Rorer Inc.,* 51 F.3d 1293, 1302 (7th Cir. 1995) (ordering the decertification of a 50-state class alleging a state-law negligence claim in part because the voices of the quasi-sovereign states "sing negligence with a different pitch," making it impossible for one jury to take into account the nuances of 50 applicable standards); *In the Matter of Bridgestone/Firestone, Inc.,* 288 F.3d 1012 (7th Cir. 2002).

Defending the manageability of the class, Ms. Carnegie argues that the defendants have not demonstrated substantial or confusing differences among the states in the law that would be applied to the class' claims. Ms. Carnegie misunderstands her task; it is *she* who bears the burden of demonstrating manageability and the absence of variability in state law. *See, e.g., In re Synthroid Mktg. Litig.,* 188 F.R.D. 287, 294 (N.D. Ill. 1999) ("The burden is on plaintiffs to

demonstrate that a class is appropriate for certification. The plaintiffs have not . . . demonstrated how a national class action on their common law claims would be manageable."); *Tylka v. Gerber Prods. Co.*, 178 F.R.D. 493, 498 (N.D. Ill. 1998) (denying certification of a nationwide class because "Plaintiffs fail to meet their burden and demonstrate that the nuances of 50 consumer fraud statutes and 50 common laws are manageable"). Ms. Carnegie has failed to show the similarities of state law which would justify certification of the plaintiff class as to those claims.

As a last resort, Ms. Carnegie argues that state-by-state variation may be resolved by sub-classing, but she has made no motion for the creation of sub-classes, and at any rate whether the inclusion of fifty sub-classes would improve manageability is an open question. If the laws of the fifty states all follow one of a small number of identical standards, Ms. Carnegie has not made any attempt to prove that this is the case. Judging from the cases cited by the defendants, who do a much more thorough job of analyzing the question than the plaintiff, the state law which governs each of Ms. Carnegie's claims varies widely and would be extremely difficult to categorize.

A nationwide litigation class cannot be certified as to the state law claims in Counts III, IV, V, and VIII. Certification is withdrawn as to those counts.

IV.

The briefs in this case raise certain issues concerning the parties which do not relate directly to any particular count in the complaint. Both defendants argue that Ms. Carnegie has named defendants against whom she has no claim. Block alleges that H & R Block Eastern Tax Services is the only appropriate Block defendant, as it was the only Block entity which had any interaction with Ms. Carnegie. Beneficial

makes a similar argument, stating that only Beneficial National Bank may properly be sued, and that the other Beneficial defendants are innocent victims of Ms. Carnegie's indiscriminate naming of defendants. At the pleading stage, a consumer plaintiff cannot be expected to express a complete understanding of the relationships among the holdings in a complex corporate structure. At this time, it is beyond the ability of both the plaintiff and this court to determine which Block entities and which Beneficial entities are ultimately responsible for the actions at issue in this suit. Therefore, I decline to dismiss any defendants from the suit.

The defendants also point out that RAL agreements after 1996 included an arbitration clause. In his order of January 11, 1999, Judge Zagel ruled that these arbitrations were enforceable. Carnegie argues that this decision does not preclude reconsideration of the question, because at the time of that decision, the class was represented by counsel later held by the court to be deficient, and it would be improper to enforce a ruling against the class. While I agree with this argument, I also agree with Judge Zagel's reasoning in that order. The Seventh Circuit strongly favors enforcement of arbitration provisions, and has declined to override them even in far more adhesive circumstances than those surrounding the RAL transactions. *See, e.g., Hill v. Gateway 2000, Inc.,* 105 F.3d 1147 (7th Cir. 1997); *Champ v. Siegel Trading Co., Inc.,* 55 F.3d 269 (7th Cir. 1995). Contrary to Carnegie's argument, the defendants' involvement in settlement proceedings over the last several years does not constitute an election of legal remedies and corresponding waiver of the right to arbitrate. The class in this case excludes those RAL customers whose contracts included agreements to arbitrate disputes arising from the transaction.

Finally, the defendants challenge Carnegie's ability to represent the class, alleging that the facts of her claim are

atypical. In particular, they point to her lack of reliance on deceptive advertising and her failure to read the RAL application before signing it. These attributes of the plaintiff's experience are examples of the type of individual variation which necessarily distinguishes class members from one another in every class action. No two individuals' claims will ever be identical; the question is whether the named plaintiff's claim "arises from the same event, practice, or course of conduct that gives rise to the claim of other class members and is based upon the same legal theory as other class claims." *Ringswald v. County of DuPage,* 196 F.R.D. 509, 512 (N.D. Ill. 2000). Carnegie's claim meets this standard. The defendants' arguments that Carnegie's history provide special problems for her breach of fiduciary duty and consumer fraud claims are mooted by the decertification of those claims. Carnegie has satisfied the typicality requirement and may serve as class representative.

Elaine E. Bucklo

United States District Judge

Dated: March 29, 2004

APPENDIX C

Cheryl Reynolds, et al., Plaintiffs-Appellees,
v.
Beneficial National Bank, et al., Defendants-Appellees.
Appeals of: Belinda Peterson, et al.

Nos. 00-3122, 00-3178, 00-3181, 00-3182, 00-3367, 01-1239, 01-1617, 01-1654, 01-2231, 01-2339, 01-2445, 01-2747, 01-2785, & 01-3545

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

288 F.3d 277; 2002 U.S. App. LEXIS 7384; 52 Fed. R. Serv. 3d (Callaghan) 1006

February 12, 2002, Argued

April 23, 2002, Decided

Before Cudahy, Posner, and Rovner, Circuit Judges.

Posner, Circuit Judge. We have consolidated for decision a number of appeals from orders by the district court approving a settlement of consumer-finance class action litigation, denying petitions to intervene, and awarding attorneys' fees. "Federal Rule of Civil Procedure 23(e) requires court approval of any settlement that effects the dismissal of a class action. Before such a settlement may be approved, the district court must determine that a class action settlement is fair, adequate, and reasonable, and not a product of collusion." *Joel A. v. Giuliani,* 218 F.3d 132, 138 (2d Cir. 2000). The principal issue presented by these appeals is whether the district judge discharged the judicial duty to protect the members of a class in class action litigation from

lawyers for the class who may, in derogation of their professional and fiduciary obligations, place their pecuniary self-interest ahead of that of the class. This problem, repeatedly remarked by judges and scholars, *see, e.g.*, *Culver v. City of Milwaukee*, 277 F.3d 908, 910 (7th Cir. 2002); *Greisz v. Household Bank (Illinois), N.A.*, 176 F.3d 1012, 1013 (7th Cir. 1999); *Rand v. Monsanto Co.*, 926 F.2d 596, 599 (7th Cir. 1991); *Duhaime v. John Hancock Mutual Life Ins. Co.*, 183 F.3d 1, 7 (1st Cir. 1999); John C. Coffee, Jr., *Class Action Accountability: Reconciling Exit, Voice, and Loyalty in Representative Litigation*, 100 Colum. L. Rev. 370,-385-93 (2000); David L. Shapiro, *Class Actions: The Class as Party and Client*, 73 Notre Dame L. Rev. 913, 958-60 and n.132 (1998), requires district judges to exercise the highest degree of vigilance in scrutinizing proposed settlements of class actions. We and other courts have gone so far as to term the district judge in the settlement phase of a class action suit a fiduciary of the class, who is subject therefore to the high duty of care that the law requires of fiduciaries. *Culver v. City of Milwaukee, supra*, 277 F.3d at 915; *Stewart v. General Motors Corp.*, 756 F.2d 1285, 1293 (7th Cir. 1985); *In re Cendant Corp. Litigation*, 264 F.3d 201, 231 (3d Cir. 2001); *Grant v. Bethlehem Steel Corp.*, 823 F.2d 20, 22 (2d Cir. 1987).

We do not know whether the $ 25 million settlement that the district judge approved is a reasonable amount given the risk and likely return to the class of continued litigation; we do not have sufficient information to make a judgment on that question. What we do know is that, as in such cases as *In re General Motors Corp. Engine Interchange Litigation*, 594 F.2d 1106, 1124 (7th Cir. 1979); *Ficalora v. Lockheed California Co.*, 751 F.2d 995, 997 (9th Cir. 1985) (per curiam); *Holmes v. Continental Can Co.*, 706 F.2d 1144, 1150-51 (11th Cir. 1983), and *Pettway v. American Cast Iron Pipe Co.*, 576 F.2d 1157, 1214, 1218-19 (5th Cir. 1978), the

judge did not give the issue of the settlement's adequacy the care that it deserved.

This litigation arose out of refund anticipation loans made jointly by the two principal defendants, Beneficial National Bank and H & R Block, the tax preparer. When H & R Block files a refund claim with the Internal Revenue Service on behalf of one of its customers, the customer can expect to receive the refund within a few weeks unless the IRS decides to scrutinize the return for one reason or another. But even a few weeks is too long for the most necessitous taxpayers, and so Beneficial through Block offers to lend the customer the amount of the refund for the period between the filing of the claim and the receipt of the refund. The annual interest rate on such a loan will often exceed 100 percent--easily a quarter of the refund, even though the loan may be outstanding for only a few days. Block arranges the loan but Beneficial puts up the money for it. Not disclosed to the customer is the fact that Beneficial pays Block a fee for arranging the loan and that Block also owns part of the loan.

Beginning in 1990, more than twenty class actions were brought against the defendants on behalf of the refund-anticipation borrowers. The suits charged a variety of violations of state and federal consumer-finance laws and also breach of fiduciary duty under state law. Some of the alleged violations appear to be technical. The most damaging charge appears to be that Block's customers are led to believe that Block is acting as their agent or fiduciary, much as if they had hired a lawyer or accountant to prepare their income tax returns, as affluent people do, whereas Block is, without disclosure to them, engaged in self-dealing.

Most of the suits failed on one ground or another; none has resulted in a final judgment against Beneficial or Block. But in the late 1990s several withstood motions to dismiss or

motions for summary judgment, and at least one, a Texas suit, was slated for trial.

On September 3, 1997, two lawyers who had prosecuted two of the unsuccessful class actions, Howard Prossnitz and Francine Schwartz, had lunch in Chicago with Burt Rublin, who was and remains Beneficial's lead lawyer in defending against the class-action avalanche. Prossnitz and Schwartz brought with them to the lunch another lawyer, Daniel Harris. Although neither Prossnitz nor Schwartz, nor their friend Harris, had a pending suit against Beneficial (or against Block, which was not represented at the lunch), they discussed "a global RAL settlement" with Rublin. It is doubtful whether Prossnitz or Schwartz even had a client at this time; and certainly Harris did not. Schwartz later "bought" a client from another lawyer, to whom she promised a $ 100,000 referral fee. The necessity for such a transaction, when the class contains 17 million members, eludes our understanding.

In the hearing before the district judge on the adequacy of the settlement (the "fairness hearing," as it is called), Harris testified that at the lunch Rublin "'threw out' a number, for purposes of illustration, of $ 24 or $ 25 million." The judge described this testimony (which he elsewhere describes as "Harris believes he heard Rublin say the case was worth $ 23 or $ 24 million"), though it is vociferously denied by Rublin, as "credible." There was, however, no actual settlement negotiation at the lunch.

Prossnitz, Schwartz, and Harris, all solo practitioners, brought a substantial law firm, Miller Faucher and Cafferty LLP, into the picture. In April of the following year the foursome filed two class action suits against Beneficial similar to the others that had been filed and that were (those that hadn't flopped) wending their way through the courts of various states. One of the two suits filed also named as

defendants H & R Block and three affiliated Block entities, but three of those, including Block itself, were voluntarily dismissed from the suit by the plaintiffs in October 1998 and the fourth was dismissed in February 1999. Shortly after the suits were filed, Harris made a settlement offer to Beneficial that was rejected, but after a hiatus negotiations began. Block was included in the settlement negotiations, despite the fact that there were by then no claims pending against it. It was included because Beneficial was reluctant to settle without Block, having promised to indemnify it for any liability resulting from Block's role in Beneficial's refund anticipation loans.

In October of 1999, a class jointly represented by the three solo practitioners and the Miller firm (we'll call these the "settlement class lawyers"), plus Beneficial and Block, entered into a settlement agreement which they submitted to the district court for its approval. The agreement contemplated the filing of an amended complaint naming H & R Block as a defendant, and by its terms covered claims against five Block entities, of which four were the entities originally named but subsequently dismissed as defendants in one of the two original class action complaints. The agreement defined the class as all persons who had obtained refund anticipation loans from Beneficial between January 1, 1987, and October 26, 1999, and provided for the release of all claims "arising out of or in any way relating to the tax refund anticipation loans ('RALs,' sometimes erroneously referred to as 'Rapid Refunds') obtained by the Class at any time up to and through" that date. The defendants agreed to create a fund of $ 25 million against which members of the class could file a claim not to exceed $ 15. Any money left in the fund after the expiration of the period for filing claims was to revert to the defendants, who also agreed to injunctive relief in the form of certain required disclosures to future customers, primarily of the financial arrangements between

Beneficial and Block, and to bear the cost of notice to class members and of the class counsel's legal fees out of their own pockets rather than out of the settlement fund. One RAL class action, the Basile suit pending in the Pennsylvania courts, was excluded from the agreement, apparently because Block thought it could get the supreme court of that state to reverse a lower court decision that had gone against the company. Beneficial and Block agreed to split the expense of the settlement 50-50.

The district judge approved the settlement except for the reversion and the $ 15 cap, which at his insistence the parties raised to $ 30 for those members of the class (apparently the vast majority) who had received two or more tax refund anticipation loans from Block. With these changes the settlement was approved and notices mailed to 17 million persons--most of whom ignored them; several million of the notices, moreover, were undeliverable, presumably because the addressees had moved and left no forwarding address. Only 1 million of the recipients filed claims, which would be enough, however, to exhaust the settlement fund. Only about 6,000 of the recipients opted out of the class action so that they could seek additional relief against the defendants.

Incidentally, there is an unremarked conflict of interest within the class, between those class members who took out one or two refund anticipation loans and those who took out more than two and thus will receive no compensation for the additional damages that they incurred. Conflicts of interest can create serious problems for class action settlements, *see, e.g., Amchem Products, Inc. v. Windsor,* 521 U.S. 591, 626-27, 117 S. Ct. 2231, 138 L. Ed. 2d 689 (1997); *Retired Chicago Police Ass'n v. City of Chicago,* 7 F.3d 584, 598 (7th Cir. 1993), and require the creation of separately represented subclasses. But in light of the modesty of the stakes even of class members who had multiple refund

anticipation loans and the expense of subdividing the class (and how many subdivisions would be necessary to reflect the full range of damages?), we are not disposed to regard this particular defect in the settlement as fatal.

In finding that $ 25 million was an adequate settlement, the judge relied in part on an unsworn report by James Adler, an accountant who purported to estimate the damages caused by the defendants' alleged violations of law. He was not deposed or subjected to cross-examination and the judge did not discuss the adequacy of his methodology. Adler came up with a figure of $ 60 million, but it is unclear whether this was intended to be an estimate of the entire damages that the class might hope to recover if the case was tried and went to judgment and what legal assumptions underpinned the estimates.

The various objectors to the settlement, primarily intervening or would-be intervening plaintiffs who have claims that the settlement will release, contend that the settlement agreement is the product of a "reverse auction", the practice whereby the defendant in a series of class actions picks the most ineffectual class lawyers to negotiate a settlement with in the hope that the district court will approve a weak settlement that will preclude other claims against the defendant. *Blyden v. Mancusi,* 186 F.3d 252, 270 n.9 (2d Cir. 1999); *Coffee, supra,* at 392; Samuel Issacharoff, *Governance and Legitimacy in the Law of Class Actions,* 1999 Sup. Ct. Rev. 337, 388; Marcel Kahan & Linda Silberman, *The Inadequate Search for 'Adequacy' in Class Actions: A Critique of Epstein v. MCA, Inc.*, 73 N.Y.U. L. Rev. 765, 775 (1998); John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class Action,* 95 Colum. L. Rev. 1343, 1370-73 (1995). The ineffectual lawyers are happy to sell out a class they anyway can't do much for in exchange for generous attorneys' fees, and the defendants are happy to

pay generous attorneys' fees since all they care about is the bottom line--the sum of the settlement and the attorneys' fees--and not the allocation of money between the two categories of expense. The defendants agreed to pay attorneys' fees in this case, to the three solo practitioners and the law firm that negotiated the settlement, of up to $ 4.25 million.

Although there is no proof that the settlement was actually collusive in the reverse-auction sense, the circumstances demanded closer scrutiny than the district judge gave it. He painted with too broad a brush, substituting intuition for the evidence and careful analysis that a case of this magnitude, and a settlement proposal of such questionable antecedents and circumstances, required. The initial agreement submitted for the judge's approval, remember, had provided for a reversion and also capped each class member's recovery at $ 15. If the parties had an inkling that only 1 million class members would file claims, they were agreeing to a settlement worth only $ 15 million, and probably less; for if 1 million class members filed claims capped at $ 30, fewer would have filed claims capped at $ 15. Yet according to a credibility determination by the district judge that we are not in a position to second guess, two and half years earlier, before RAL plaintiffs began having some success in the courts, Beneficial's counsel had indicated that $ 23 to $ 25 million were ballpark figures for a settlement with Beneficial alone. Beneficial's share of a $ 15 million settlement in which Block was a codefendant would be only $ 7.5 million (remember that Beneficial and Block agreed to split the cost of the settlement 50-50)--yet that is the settlement the lawyers for the settlement class agreed to, plus injunctive relief the value of which no one has attempted to monetize and which is barely discussed in the briefs or by the judge. The injunctive relief signally does not include a requirement

that H & R Block disclose its interest in Beneficial's refund anticipation loans.

Moreover, H & R Block appears to have faced substantial exposure in a Texas class action in which it was accused of breach of fiduciary obligations to its customers. The class in that suit was seeking disgorgement of all the fees paid to Block by the banks that made refund anticipation loans through it. The class argued that such a forfeiture was mandatory if Block was found to have violated its fiduciary duties. Disgorgement was also sought of all other fees that Block had received "in connection with each RAL transaction"--that is, the tax-preparation and electronic-filing fees that Block had charged its RAL customers to file their taxes for them--a form of relief that the class claimed was within the trial court's equitable discretion. The total amount sought could have reached $ 2 billion. The class had been certified, the case was proceeding in the Texas courts, and the theory of liability and damages could not be dismissed as frivolous; indeed, the case had been set for trial. Even if the class had only a 1 percent chance of prevailing, the expected value of its suit might reach $ 20 million. (This is on the unrealistic assumption that the only possible outcomes were a $ 2 billion judgment and a zero judgment. Realistic intermediate possibilities could make the $ 20 million estimate expand or shrink.)

Remarkably in view of the progress and promise of the Texas suit relative to the half-hearted efforts of the settlement class counsel, the district judge enjoined the Texas suit on the authority of the All Writs Act, 28 U.S.C. § 1651(a), reasoning that the suit might upend the settlement. *In re VMS Securities Litigation,* 103 F.3d 1317, 1323-24 (7th Cir. 1996); *In re Agent Orange Product Liability Litigation,* 996 F.2d 1425, 1431-32 (2d Cir. 1993); *In re Baldwin-United Corp. (Single Premium Deferred Annuities Ins. Litigation),*

770 F.2d 328, 335-38 (2d Cir. 1985). The effect of the injunction is that the settlement release, if upheld, will release the claims in the Texas suit. For this release of potentially substantial claims against H & R Block the settlement class received no consideration. In fact the settlement class received no consideration for the release of any claims against Block. The only effect of bringing Block into the settlement was to allow Beneficial to cut its own expense of the settlement in half. The lawyers for the settlement class were richly rewarded for negotiations that greatly diminished the cost of settlement to Beneficial from the level that it had considered to be in the ballpark years earlier when the cases were running more in its favor than when the settlement agreement was negotiated. In effect, the settlement values the Texas and all other claims against Block at zero.

The district judge enjoined the lawyers for the Texas class from notifying the members of that class of the status of the Texas litigation to assist them in deciding whether to opt out of the settlement that the settlement class counsel had negotiated with Beneficial and Block and continue to litigate in the Texas courts. The judge should not have done this, especially since opting out was likely to be the sensible course of action given the ungenerosity of the settlement to the Texas class. A pattern of withholding information likely to undermine the settlement emerged when, after approving the settlement, the district judge encouraged the solo practitioners to submit their fee applications in camera, lest the paucity of the time they had devoted to the case (for which the judge awarded them more than $ 2 million in attorneys' fees) be used as ammunition by objectors to the adequacy of the representation of the class. There was no sound basis for sealing the fee applications, let alone for sealing the number of hours each of the settlement class counsel had devoted to the case. The applications are not in

the appellate record and we do not know what the total number of hours devoted by the class counsel to this litigation was, but apparently it was a small number. This is not surprising, since the lawyers' efforts between the filing of the complaint and the settlement negotiations were singularly feeble, illustrated by their responding to the Block defendants' motion to dismiss for lack of personal jurisdiction with a voluntary dismissal of the claims against those defendants. Their representation of the class was almost certainly inadequate, an independent reason for disapproving a settlement. *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 856, 119 S. Ct. 2295, 144 L. Ed. 2d 715 and n.31 (1999); *Culver v. City of Milwaukee, supra,* 277 F.3d at 913; *Linney v. Cellular Alaska Partnership,* 151 F.3d 1234, 1238-39 (9th Cir. 1998). But in addition it reinforces our concern with the adequacy of the district judge's consideration of the settlement.

The judge approved the settlement primarily because he thought the prospects for the class if the litigation continued were uncertain. They might lose in the end, or win little; and even if they won a lot, the delay in winning would make the relief eventually awarded the class worth much less in present-value terms. To most people, a dollar today is worth a great deal more than a dollar ten years from now. It is especially likely to be worth more to the members of the class in this litigation. Only a person with a very high discount rate (that is, a strong preference for present over future dollars--a preference that may reflect desperation rather than fecklessness or shortsightedness) would borrow at an astronomical interest rate in order to get a sum of money now rather than a few weeks from now.

All this is true, but in the suspicious circumstances that we have recited the judge should have made a greater effort (he made none) to quantify the net expected value of continued

litigation to the class, since a settlement for less than that value would not be adequate. Determining that value would require estimating the range of possible outcomes and ascribing a probability to each point on the range, *In re General Motors Corp. Engine Interchange Litigation, supra,* 594 F.2d at 1132-33 n.44, though as just noted those outcomes must be discounted to the present using a reasonable, and in this case perhaps a steep, interest rate. *In re General Motors Corp. Pick-Up Truck Fuel Tank Products Liability Litigation,* 55 F.3d 768, 806 (3d Cir. 1995); *cf. Transcraft, Inc. v. Galvin, Stalmack, Kirschner & Clark,* 39 F.3d 812, 819 (7th Cir. 1994). We say "perhaps" because even a person with a high discount rate may not care much whether he receives $ 15 to $ 30 now or in the future, since it is such a trivial amount of money even to a person who is usually strapped for funds. If, moreover, the court would award prejudgment interest in a case litigated to judgment, discounting might wash out of the picture altogether.

A high degree of precision cannot be expected in valuing a litigation, especially regarding the estimation of the probability of particular outcomes. Still, much more could have been done here without (what is obviously to be avoided) turning the fairness hearing into a trial of the merits. For example, the judge could have insisted that the parties present evidence that would enable four possible outcomes to be estimated: call them high, medium, low, and zero. High might be in the billions of dollars, medium in the hundreds of millions, low in the tens of millions. Some approximate range of percentages, reflecting the probability of obtaining each of these outcomes in a trial (more likely a series of trials), might be estimated, and so a ballpark valuation derived.

Some arbitrary figures will indicate the nature of the analysis that we are envisaging. Suppose a high recovery

were estimated at $ 5 billion, medium at $ 200 million, low at $ 10 million. Suppose the midpoint of the percentage estimates for the probability of victory at trial was .5 percent for the high, 20 percent for the medium, and 30 percent for the low (and thus 49.5 percent for zero). Then the net expected value of the litigation, before discounting, would be $ 68 million; discounting, depending on an estimate of the likely duration of the litigation, would bring this figure down, though probably not to $ 25 million--and any discounting might be inappropriate, as we explained. These figures are arbitrary; our point is only that the judge made no effort to translate his intuitions about the strength of the plaintiffs' case, the range of possible damages, and the likely duration of the litigation if it was not settled now into numbers that would permit a responsible evaluation of the reasonableness of the settlement.

Two classes were absorbed into the settlement even though their claims were sharply different from those of the classes represented by the settlement counsel. A class action brought by Belinda Peterson years before the suit that gave rise to the settlement complained of Block's promise, for which it levied a separate charge, that a customer would receive a "rapid refund" from the IRS. The Peterson class alleges that Block knew that customers such as Peterson who were seeking a refund on the basis of the Earned Income Tax Credit would not receive it rapidly because the IRS was subjecting this class of refund requests to special scrutiny. No loan was involved. The district judge nevertheless held that the Peterson class was embraced by the settlement and release, meaning that the members of the class would be entitled to damages of $ 15 apiece, period. The settlement class counsel had never complained about, or so far as appears knew anything about, the rapid refunds, and indeed Harris testified that the Peterson class was intended to be excluded from the settlement. "Rapid Refunds" are

mentioned in the release only because the term is sometimes used to describe refund anticipation loans, an entirely different practice from Block's promise of a rapid refund. Whatever injury the promise caused Block's customers is not measured by the $ 15 award, which was an estimate of the injury inflicted by violations connected with refund anticipation loans. The Peterson class was included in the settlement as a result of a purely semantic coincidence.

Another class that got swept up in the settlement as it were accidentally, the Carbajal class, was complaining about the defendants' "intercepting" IRS refunds in order to offset debts owed by the customer on previous refund anticipation loans. Block would apply to the IRS for a refund for its customer but direct that the refund be paid to it, and it would then deduct whatever the customer owed it and its partner lending institutions and forward the balance (if any) to the customer. This practice was distinct from nondisclosure, misrepresentation, and other alleged wrongs concerning the making of refund anticipation loans. The relation was closer than in the case of the rapid refunds, because the interception practice, though not involving a loan as such, involved an effort to collect debts based on past refund anticipation loans. But the $ 15 damages award that the members of the Carbajal class received as part of the settlement that the district judge approved was just as unrelated to whatever injury the interception inflicted on them.

All things considered, we conclude that the district judge abused his discretion in approving the settlement. Because of this conclusion, the other issues raised by the appeals need not be decided, but for guidance on remand we will address the principal ones, which concern attorneys' fees. To begin with, we disapprove the practice (a practice we had never heard of and can find no case law concerning) of encouraging or permitting the submission of fee applications in camera. In

the unlikely event that some confidential information is contained in the applications, that information can be whited out. To conceal the applications and in particular their bottom line paralyzes objectors, even though inflated attorneys' fees are an endemic problem in class action litigation and the fee applications of such attorneys must therefore be given beady-eyed scrutiny by the district judge. *Gunter v. Ridgewood Energy Corp.*, 223 F.3d 190, 192 (3d Cir. 2000); 7B Charles Alan Wright, Arthur R. Miller & Mary Kay Kane, *Federal Practice and Procedure* § 1803, pp. 510-11 (2d ed. 1986). Second, class counsel's compensation must be proportioned to the incremental benefits they confer on the class, not the total benefits. Supposing that with absolutely minimal effort the class counsel could, as appears to be the case, have obtained a settlement for $ 20 million back in 1997 when they met with Rublin, the question would be how much they should be rewarded for having pushed the settlement up to $ 25 million. Surely not the $ 4.25 million that the judge pursuant to the agreement between the parties to the settlement awarded, especially since the class counsel, but for prodding by the judge, would have settled for less than Rublin appears to have been prepared to offer years earlier.

Several lawyers, each representing a class member, appeared at the fairness hearing to object to various features of the proposed settlement, primarily the reversion which the judge later struck. They wanted a fee for having conferred a benefit on the class by arguing successfully against the reversion. The judge turned them down.

An initial question is whether we have jurisdiction of their appeals, since their clients, although members of the class, were denied intervention in the district court and are not appealing that denial. These plaintiffs say they have no reason to be parties at this stage because they are content with the revised settlement, which axed the reversion.

Ordinarily only a party to a litigation, including a class action, can appeal. *Marino v. Ortiz*, 484 U.S. 301, 304, 108 S. Ct. 586, 98 L. Ed. 2d 629 (1988) (*per curiam*); *Karcher v. May*, 484 U.S. 72, 77, 108 S. Ct. 388, 98 L. Ed. 2d 327 (1987); *In re Navigant Consulting, Inc., Securities Litigation*, 275 F.3d 616, 617-18 (7th Cir. 2001). (Not all courts agree that a class member can appeal only if he has intervened and thus become a named party; the line up is reviewed in *Scardelletti v. Debarr*, 265 F.3d 195, 205-06, 209 (4th Cir.), *cert. granted*, 122 S. Ct. 663 (2001).) But to this as to most legal generalizations there are exceptions--*see, e.g.*, *United States Catholic Conference v. Abortion Rights Mobilization, Inc.*, 487 U.S. 72, 76, 108 S. Ct. 2268, 101 L. Ed. 2d 69 (1988), recognizing the right of third-person witnesses, not named parties to the case, to appeal from a contempt citation for noncompliance with subpoenas served on them by a named party--most relevantly for cases in which a lawyer appeals from a sanction imposed on him, *Vollmer v. Publishers Clearing House*, 248 F.3d 698, 701, 705, 711 (7th Cir. 2001); *Corroon v. Reeve*, 258 F.3d 86, 88, 90, 92 (2d Cir. 2001), or from the denial of a motion for fees. *Gaskill v. Gordon*, 160 F.3d 361, 362-63 (7th Cir. 1998); *Florin v. Nationsbank of Georgia, N.A.*, 34 F.3d 560, 562 and n.1 (7th Cir. 1994); *In re Continental Illinois Securities Litigation*, 962 F.2d 566, 568 (7th Cir. 1992). The lawyer doesn't have to move to intervene in the district court in order to appeal to us; nor does the objector have to move to intervene in order to appeal the lawyer's fee. *Powers v. Eichen*, 229 F.3d 1249, 1251, 1256 (9th Cir. 2000); *Rosenbaum v. MacAllister*, 64 F.3d 1439, 1441-43 (10th Cir. 1995); *see also Zucker v. Occidental Petroleum Corp.*, 192 F.3d 1323, 1326 (9th Cir. 1999). We just the other day rejected the proposition that a lawyer must be made a party before he can be ordered to disgorge a fee wrongfully retained, and though not a party

the lawyer was permitted to appeal the order. *Dale M. v. Board of Education,* 282 F.3d 984 (7th Cir. 2002).

The situation here is similar. The clients being content with the settlement, the only issue is whether their lawyers are entitled to a fee. They are in effect volunteer lawyers for the class asking that they receive a fee for their efforts. We think they can appeal without their clients' having intervened. Intervention would not only be a pointless formality. *Powers v. Eichen, supra,* 229 F.3d at 1256. It would be a futile one. For the clients, being content with the settlement, could not appeal even if they were parties, because they seek no relief from us and standing must continue throughout the entire litigation. *United States Parole Comm'n v. Geraghty,* 445 U.S. 388, 397, 100 S. Ct. 1202, 63 L. Ed. 2d 479 (1980); *Levin v. Attorney Registration & Disciplinary Comm'n,* 74 F.3d 763, 767 and n.5 (7th Cir. 1996); *Chong v. District Director, INS,* 264 F.3d 378, 383-84 (3d Cir. 2001). Unless the lawyers can appeal, there will be no appellate review of the district judge's decision not to award them fees.

It would be a different case if the claim for attorneys' fees rested on a fee-shifting statute, so that the money would come from the defendants and not diminish the $ 25 million fund. Then the objectors would have to intervene, because it is the litigants rather than the lawyers who hold the entitlement to awards under fee-shifting statutes. *Central States, Southeast & Southwest Areas Pension Fund v. Central Cartage Co.,* 76 F.3d 114, 116 (7th Cir. 1996). The objectors might be obliged by contract to pay these sums to their lawyers, but that would not make the lawyers parties. To be entitled to appeal, however, the objectors would have to become parties.

But in fact the lawyers are claiming fees in their own name, so that any fees awarded to them would come from the

$ 25 million fund under the common-fund doctrine. When a lawyer lays claim to a portion of the kitty, he becomes a real party in interest; and should he therefore have to intervene--not only for purposes of taking an appeal himself but so that he will be an appellee if class members oppose the district court's award and want the money back? We do not see why a person who has received money by order of the district court at the expense of a party must be named as a party in order for the party harmed by the order to be able to appeal. After all, a defendant could appeal from a fee award to the plaintiff's lawyer that he thought excessive.

We need not pursue this interesting question, on which the Supreme Court may shed considerable light when it decides the Scardelletti case, any further, since the claim for attorneys' fees falls with the settlement. But assuming these lawyers can appeal, let us for the sake of guidance for the future consider the merits of their appeals.

The law generally does not allow good Samaritans to claim a legally enforceable reward for their deeds. *Nadalin v. Automobile Recovery Bureau, Inc.*, 169 F.3d 1084, 1086 (7th Cir. 1999); Saul Levmore, *Explaining Restitution*, 71 Va. L. Rev. 65 (1985). But when professionals render valuable albeit not bargained-for services in circumstances in which high transaction costs prevent negotiation and voluntary agreement, the law does allow them to claim a reasonable professional fee from the recipient of their services. *Gaskill v. Gordon, supra,* 160 F.3d at 363; *In re Continental Illinois Securities Litigation, supra,* 962 F.2d at 568, 571; *Levmore, supra*, at 66. That is the situation of objectors to a class action settlement. It is desirable to have as broad a range of participants in the fairness hearing as possible because of the risk of collusion over attorneys' fees and the terms of settlement generally. This participation is encouraged by permitting lawyers who contribute materially

to the proceeding to obtain a fee. *Gottlieb v. Barry,* 43 F.3d 474, 490-91 (10th Cir. 1994); *Fisher v. Procter & Gamble Mfg. Co.,* 613 F.2d 527, 547 (5th Cir. 1980); *White v. Auerbach,* 500 F.2d 822, 828 (2d Cir. 1974).

The principles of restitution that authorize such a result also require, however, that the objectors produce an improvement in the settlement worth more than the fee they are seeking; otherwise they have rendered no benefit to the class. *Class Plaintiffs v. Jaffe & Schlesinger, P.A.,* 19 F.3d 1306, 1308 (9th Cir. 1994) (*per curiam*); *see also Stewart v. General Motors Corp., supra,* 756 F.2d at 1294; *Petrovic v. Amoco Oil Co.,* 200 F.3d 1140, 1156 (8th Cir. 1999).

The judge denied a fee to the objectors in part on the ground that he had already decided, without telling anybody, not to accept the reversion. But objectors must decide whether to object without knowing what objections may be moot because they have already occurred to the judge. A compelling ground for denying the objectors a fee in this case does exist, however. It is that other lawyers at the hearing, notably counsel for the Carnegie intervenors, had vigorously objected to the reversion; the objectors added nothing. *In re Synthroid Marketing Litigation,* 264 F.3d 712, 722-23 (7th Cir. 2001). For similar reasons the judge was correct to deny intervention to class representatives (Mitchell, Westfall, Ramsey, Jones, Vaughn, and Longo) whose arguments had already been covered by existing plaintiffs. Fed. R. Civ. P. 24(a)(2).

The judgment approving the class action settlement and awarding attorneys' fees is reversed and the case is remanded to the district court for further proceedings consistent with this opinion. The injunction against the Texas class action must be vacated in light of our disapproval of the settlement. See *Bradford Exchange v. Trein's Exchange,* 600 F.2d 99, 101-02 (7th Cir. 1979) (*per curiam*); *cf. Rufo v. Inmates of*

Suffolk County Jail, 502 U.S. 367, 383, 112 S. Ct. 748, 116 L. Ed. 2d 867 (1992); *In re Hendrix,* 986 F.2d 195, 198 (7th Cir. 1993). The action of a panel of this court in upholding the district judge's interlocutory injunction against the Texas suit, entered while settlement negotiations were in process, does not bear on the validity of the final injunction, which is an incident of the settlement agreement and falls with it.

Finally, we have decided that Circuit Rule 36 shall apply on remand.

Reversed and Remanded.

APPENDIX D

CHERYL REYNOLDS and NANNIE TRIPLETT, on behalf of themselves and all others similarly situated, Plaintiffs,

vs.

BENEFICIAL NATIONAL BANK, BENEFICIAL TAX MASTERS, INC. and H & R BLOCK, INC., Defendants.

DECARLO TURNER, on behalf of herself and all the class of similarly situated borrowers, Plaintiffs, vs. BENEFICIAL NATIONAL BANK and BENEFICIAL TAX MASTERS, Defendants.

No. 98 C 2178, No. 98 C 2550

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

260 F. Supp. 2d 680; 2003 U.S. Dist. LEXIS 6422

April 15, 2003, Decided

April 16, 2003, Docketed

Elaine E. Bucklo, United States District Judge.

MEMORANDUM OPINION AND ORDER

This case is before me on remand from the Seventh Circuit pursuant to local Circuit Rule 36. *Reynolds v. Beneficial National Bank,* 288 F.3d 277 (7th Cir. 2002). In that decision the Seventh Circuit concluded that the circumstances surrounding the settlement of this litigation were suspicious and that it did not have enough information to determine if the settlement was fair. Lawyers for

proponents of the settlement and objectors have filed various papers before me and presented argument and witnesses on three days. I decline to approve the settlement.

Two complaints were filed in April, 1998. The first, 98 C 2178, was brought by Joel Zawikowski, Cheryl Reynolds, Debra Barnes, Phyllis Barnes and Nannie Triplett against Beneficial National Bank, Beneficial Tax Masters, Inc., H&R Block, Inc. and various H&R Block subsidiaries. That complaint alleged violations of the federal Truth in Lending Act ("TILA," 15 U.S.C. § 1601, *et seq.*), state consumer fraud statutes, breaches of contractual and fiduciary duties, and unjust enrichment. On April 28, 1998, DeCarlo Turner filed a separate complaint, No. 98 C 2550, against Beneficial National Bank and Beneficial Tax Masters, Inc., alleging violations of TILA, RICO, 18 U.S.C. § 1961, *et seq.*, and state consumer fraud statutes as well as breach of contract. The Zawikowski plaintiffs were represented by Francine Schwartz, Jennifer Sprengel, Dominic Rizzi, and Marvin Miller at the time the case began. A few weeks later, Howard Prossnitz filed an appearance on behalf of Nannie Triplett. Turner was represented by Daniel Harris. Both complaints were filed as class actions. The Turner class was defined as all persons who obtained Refund Anticipation Loans (defined below) from Beneficial National Bank from January 1, 1994 to the present, with the exception of persons who obtained their loans through Jackson Hewitt (those claims having previously been settled). The Zawikowski class claims were broader, going back to 1987 for certain claims against Beneficial and as to Block from 1996.

In essence, the complaints allege that plaintiffs - who are as a class described in pleadings or opinions in related cases, as persons who are unsophisticated, of limited education, financially strapped, and sometimes elderly - were led to believe they were obtaining a quick income tax refund

through defendants' services, while in reality they were signing documents and obtaining a loan (a Refund Anticipation Loan or "RAL") at very high interest rates, without proper timely disclosures. Among the alleged misrepresentations or failures to disclose were the real finance charges they were paying and the fact that their tax preparer in the case of Block was receiving part of that fee.

The history of these cases was summarized in the Seventh Circuit opinion. The defendants moved to dismiss the complaints. In response, in part, plaintiffs voluntarily dismissed all but one of the Block defendants. The remainder of the motion to dismiss the Zawikowski complaint was briefed and granted in part by Judge Zagel in January and February, 1999. Judge Zagel denied defendants' motion to dismiss the Turner complaint in March, 1999. In October, 1999, the plaintiffs and defendants, including Block although it had been dismissed, filed a proposed settlement agreement with the court. That settlement would pay each class member (broadly defined in a new "settlement class") who filed a claim a pro rata share of a $ 25,000,000 claim fund up to a maximum of $ 15.00, with any remaining amount to revert to defendants. Judge Zagel required that the cap be raised to $ 30.00 for claimants who had more than one RAL, and disallowed the reversion. Following hearing, to which there were objections by lawyers representing plaintiffs in actions pending in other jurisdictions whose actions would be extinguished by the settlement, the settlement, as amended, was approved. The Seventh Circuit reversed.

On remand, the proponents of the settlement have vigorously argued for its renewed approval. Initially, I severed two classes that the Seventh Circuit found to be improperly included within the settlement, the Peterson and Carbajal classes, whose claims were different from those alleged by the settlement class but who had been included in

the final settlement at the insistence of Block. I also refused to enter a new injunction (the old one had been vacated by the Seventh Circuit) enjoining proceedings in a Texas case, *Haese v. H&R Block, Inc., et al.*, which was set for trial in the fall of 2002. I held a fairness hearing on October 7 and 8 and, at the request of objectors, a further hearing on November 15, 2002. At those hearings, and in legal memoranda, the proponents of the settlement have attempted to show, through purported legal experts (I accepted their opinions as additional briefs but not as expert opinions) and economic experts whose opinions were based on the legal conclusions of the law professor "experts", that the $ 25,000,000 settlement is quantifiably fair. Objectors have focused on what they say is proof that the class was sold out by unscrupulous counsel, which they say prevents the settlement from being approved regardless of the amount, although they also argue that the cases against these defendants are worth far more than $ 25,000,000.

It is settled law that a class action settlement cannot be approved, regardless of objective fairness, if the requirements of Fed. R. Civ. P. 23, including adequacy of counsel, are not met. *Anchem Products, Inc. v. Windsor,* 521 U.S. 591, 621-22, 117 S. Ct. 2231, 138 L. Ed. 2d 689 (1997); *Reynolds,* 288 F.3d at 284. Theoretically, if the settlement is fair, adequacy might be assumed. But as has often been noted, once a settlement is agreed upon, counsel, adequate or not, will, as in this case, argue for the fairness of the settlement. The court, therefore, does not have the benefit of the adversarial argument that should enable it to reach an objective conclusion on the fairness of the settlement. *See, e.g., Kamilewicz v. Bank of Boston Corp.,* 100 F.3d 1348, 1352 (7th Cir. 1996) (Easterbrook, J., dissenting on request for rehearing en banc) ("Representative plaintiffs and their lawyers may be imperfect agents of the other class members-may even put one over on the court, in a staged

performance."). Objectors may provide some balance but in most cases they are probably reluctant to commit the substantial resources that may be needed, knowing that they may not see reimbursement.

In this case the Seventh Circuit noted that the lawyers' "representation of the class was almost certainly inadequate, an independent reason for disapproving a settlement" (288 F.3d at 284) but nevertheless sent the case back for a further examination of the settlement. Given the requirement of adequacy, noted by the Court, I conclude that it simply did not find it had sufficient information to make a definite determination of adequacy. Both sides have pursued the inquiry on remand.

The Seventh Circuit's tentative conclusion of inadequacy cited a lack of discovery, the fact that various classes were included in the settlement that did not seem appropriate, the inclusion of Block, who was not even a defendant, without additional compensation to the class, and various actions, particularly a meeting between certain counsel for plaintiffs and counsel for defendants, several months before the suits were filed. The meeting in question was a lunch at a Chicago club in September, 1997. The meeting was arranged by Ms. Schwartz, one of plaintiffs' counsel. With her was Mr. Prossnitz and Mr. Harris. Also present were Burt Rublin, Beneficial's lead lawyer and James Adducci, also a lawyer for Beneficial. The Seventh Circuit noted that no suit was pending against Beneficial at the time, that it was questionable whether Ms. Schwartz or Mr. Prossnitz had a client who might be a prospective plaintiff, and that Mr. Harris "certainly . . . did not." 288 F.3d at 280-81. Nevertheless, counsel arranged the lunch to discuss the possibility of a global settlement of RAL litigation. At the lunch, Mr. Harris later testified, Mr. Rublin "threw out a number, for purposes of illustration, of $ 24 or $ 25 million"

as a possible settlement figure. 288 F.3d at 281. While the case did not settle very soon after this, and indeed was not filed until the following April, the Seventh Circuit found the coincidence of the numbers thrown out by Mr. Rublin with the final settlement figure, and the fact that the lawyers actually agreed to an amount that was likely to be considerably less than that, particularly troublesome, especially given the other facts noted above.

On remand, proponents of the settlement argue that the Seventh Circuit was mistaken, and that Mr. Rublin did not mention even a possibility of settlement in the range of $ 25 million. Both Mr. Rublin and Mr. Adducci testified that no such conversation occurred. Mr. Prossnitz also testified, somewhat less assuredly, stating that he did not recall Mr. Rublin mentioning such a number. Mr. Harris, whose deposition testimony had been relied upon by the Seventh Circuit as well as by Judge Zagel, did not testify. Neither did Ms. Schwartz. I am not certain that the Seventh Circuit's finding in this regard is even open to question (indeed, opponents of the settlement say that the Seventh Circuit at oral argument asked Mr. Rublin if he would like them to remand the case for a hearing before Judge Zagel, at which he could testify under oath in contradiction to Mr. Harris' testimony, and Mr. Rublin turned down the offer), but the luncheon would appear to be mostly of evidentiary interest in examining the general adequacy of counsel in this case. What is particularly important about the lunch was that counsel for plaintiffs, months before they filed a case, and without in some cases even clients to represent,[1] indicated their interest in an early settlement.

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[1] Settlement proponents also dispute the Seventh Circuit finding that they did not have clients. But Mr. Harris had initially testified that he did not have a client at the time, and the Seventh Circuit so found. Ms. Schwartz' briefs in the Seventh Circuit documented the fact that she purchased a

Additional facts of record also are relevant to the representation issue. Mr. Prossnitz and Ms. Schwartz had represented plaintiffs in an earlier RAL suit in federal and then state court against Beneficial and another tax return preparer, Jackson Hewitt. *Adams v. Jackson Hewitt, Inc.*, 95 CH 11825 (Cir. Ct. Cook Cty.). The federal case had been dismissed but the state court case had survived a motion to dismiss. It had gone up to the state appellate court on a discretionary appeal, to which plaintiffs' counsel had agreed. But in the appellate court they nevertheless opposed allowing the appeal, and the state trial court held that it would impose sanctions in the form of defendants' attorneys' fees. Immediately following this order, and before a monetary amount of sanction could be imposed, plaintiffs' counsel agreed to settle the case. The settlement purported to give Jackson Hewitt a nationwide release of all RAL claims over a three year period in return for $ 75,000 in attorneys' fees, agreed dismissal of the sanctions order, and a $ 15 credit towards the cost of future tax preparation service to anyone who sent in a claim form. Notice of this settlement (which essentially gave plaintiffs nothing)[2] was to be a one time notice in USA Today. Plaintiffs' counsel also agreed not to issue press releases or talk to news media about the lawsuit

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client for a $ 100,000 referral fee and her time records indicate a retainer agreement was sent to plaintiff Reynolds after the Sept. 3 Metropolitan Club lunch.

[2] *See, e.g. In In re General Motors Corp. Pick-up Truck Fuel Tank*, 55 F.3d 768, 803 (3d Cir. 1995) ("the fact that the settlement involves only non-cash relief . . . is recognized as a prime indicator of suspect settlements"); *In re Mexico Money Transfer Litigation*, 267 F.3d 743, 748 (7th Cir. 2001) (fact customers got coupons is "enough to raise suspicions-especially because coupons serve as a form of advertising for the defendants, and their effect can be offset . . . by raising prices during the period before the coupon expires." In that case, however, the coupons were useful for a service - making wire transfers to Mexico - which plaintiffs used on average of 14 times a year.)

or its settlement. After objectors came in, the notice was increased to three times rather than once in USA Today and notice was to be placed in the Chicago Sun-Times as well. Whether counsel had a basis for concluding that a class comprised of people who generally obtained RALs through Jackson Hewitt read USA Today or (apart from Chicagoans) the Chicago Sun-Times is not known. *Cf.*, *Kamilewicz,* 100 F.3d at 1349 (discussing defective notice). At any rate, the settlement was approved. Ms. Schwartz stated in time records submitted to the court in this case that there were "very few claims" made in the case. Mr. Rublin, defendants' counsel from New York, was-in Chicago for a hearing on that settlement on the date of the September Metropolitan Club lunch.

After the Metropolitan Club lunch, the three attorneys sent defense counsel the names and social security numbers of their prospective plaintiffs and Mr. Adducci informed plaintiffs' counsel that Beneficial was not interested in a settlement. Within weeks after suit was filed the following April, Mr. Harris contacted Mr. Adducci with a settlement proposal. The proposal was for two $ 15 coupons to be used for discounts "on charges in connection with a Beneficial loan in the year" 2001 and 2002. Beneficial was to pay $ 1.6 million in cash (presumably in attorney fees, although on what basis Mr. Harris made the offer is not known because at his deposition he refused to answer any questions about the origin of the offer)[3]. Individual notice was to be given only

[3] At Mr. Harris' deposition, taken by one of the objecting plaintiffs' counsel in 1999, despite the fact that Mr. Harris was one of the attorneys who owed a fiduciary duty to all plaintiffs in the class, and presumably was to disclose the basis for his assessment that the settlement before Judge Zagel was fair, objections to questions were interposed by counsel for both the settlement proponents and defendants and many questions were unanswered.

for persons for whom Beneficial had current addresses. Beneficial would receive a release of all RAL claims that could have been asserted since the beginning of 1994. Mr. Harris admits he had obtained no discovery at the time he made this settlement proposal. Beneficial turned down this offer. However, in January, 1998, after Judge Zagel had denied part of defendants' motion to dismiss, Mr. Rublin contacted Mr. Harris and began settlement negotiations. Mr. Harris agreed to Mr. Rublin's request not to tell his fellow plaintiffs' counsel about the negotiations until he was given "permission" (his word) to do so by defendants' counsel. Defense counsel told Mr. Harris they preferred to negotiate with him alone and did not want him to lose control of the discussions. (Given his earlier indications of willingness to enter into settlement, it was of course not surprising that defense counsel sought him out.) At some point Mr. Harris understood that defense counsel wanted to reach a settlement before a class was certified in a New York case, *Affatato v. Beneficial National Bank,* 1998 U.S. Dist. LEXIS 12447, 96 C 5376 (E.D.N.Y.). He also learned that there had been decisions favorable to plaintiffs in RAL litigation involving Beneficial or Block or both in various state and federal courts in 1999. He learned as well that if there was a settlement it would include Block although Block was no longer a defendant in the Chicago cases.

With Messrs. Miller, Prossnitz, and Harris and Ms. Schwartz (the "settlements lawyers") in the two cases before this court eventually involved in the negotiations, counsel reached the settlement that was submitted to Judge Zagel in October, 1999. Essentially all of the efforts of counsel between January and October that went into this case concerned settlement. On August 10, 1999, counsel told Judge Zagel that they had reached a settlement in principle, but negotiations continued concerning the exact language of the agreement, attorneys' fees, and the kind of notice that

would be sent. The defendants refused to agree to a procedure where a rebate certificate would be mailed to the class members, insisting that a claim be filed although no information was required for the millions of members known to them. Plaintiffs' counsel agreed to this. There was also some discussion about excluding at least some of the classes in the several state and federal actions in New York, California, Illinois, Pennsylvania, Maryland and Texas, that had survived motions to dismiss and were ongoing, but except for Block class members in Pennsylvania, all were eventually encompassed within the class. Mr. Harris testified that unless plaintiffs' counsel agreed to a release that would extinguish the rights of plaintiffs in these actions they would not have a deal. At some point two of plaintiffs' counsel, Ms. Schwartz and Mr. Miller, asked for more money if they were going to agree to include a release of Block RALs from Bank One, Greenwood Trust and Mellon Bank (over 10,000,000 RALs according to Mr. Adducci), none of which were defendants but all of which were included in the broad definition of the proposed amended class. Block refused and plaintiffs acquiesced.

On February 19, 2003, prior to reviewing the time records of settlement counsel but concerned with a number of statements in the testimony at the fairness hearing, I ordered settlement counsel to provide a complete list of discovery taken in this case. An examination of the material received in response confirms what I had learned from my subsequent reading of the time records and further study of various testimony while waiting for counsel's submission. In this case, settlement counsel never served a single set of interrogatories, or a formal request for documents, and never took a single deposition of an employee of Beneficial, H&R Block, or any of the other released lenders. They obtained some documents from defendants and answers to some questions; there are, however, no sworn answers or

responses. The limited informal discovery sought prior to the time settlement had been agreed upon consisted in documents or information concerning the named plaintiffs' loans, information about H&R Block's document retention policies, pricing for RALs in various years, Block's license fee, the number of class members, a table with information about electronic filing fees and document preparation fees charged RAL customers in certain years (provided in September, after counsel had informed Judge Zagel that they had reached a settlement). In June, 1999, Mr. Harris had relayed to Mr. Adducci various questions that Ms. Schwartz had told him needed to be answered before she could agree on a settlement. (He stated in his memorandum to Mr. Adducci: "Here are Francine's questions (with some edits.") She wanted to know how many people paid $ 25, $ 35 or any other electronic filing fees, how many people paid a higher finance charge than stated in the RAL application, what was this price, what were the document preparation fees, how many people paid them, how many paid these charges when they were not included in the TILA statement, whether there were additional fees or rebates paid to Block and other loan originators, and if so, the total amount paid, the total amount of finance charges paid, Beneficial's and Block's gross income from RALs, whether there was any other category of fee charged besides the document preparation fee and the administrative fee, and who sets and who gets these fees. On July 27, 1999, Mr. Adducci wrote his co-counsel indicating that Ms. Schwartz had called him that day saying she needed the answers to her questions. On August 17, 1999, one of Mr. Adducci's co-counsel reported that plaintiffs' expert, Mr. Adler, was going to look at documents to come up with an "economic justification" for the settlement that had been reached. These were apparently a number of boxes of documents that had been produced in the New York *Affatato* litigation, which Mr. Adducci made available as

"confirmatory" discovery. Subsequently, Mr. Adducci reported to Mr. Adler that there was no index or table of contents identifying the contents of the boxes. Mr. Adducci purported to respond to Ms. Schwartz' questions in a letter dated September 1, 1999. In general he referred to two charts on which he said the answers could be found. The charts contain only the number of persons who paid particular electronic filing fees and "document fee" amounts for Beneficial in particular years. Subsequently, on October 6, 1999, in response to questions posed in "confirmatory discovery questions" by plaintiffs' expert, Mr. Adducci said he did not know how many people paid a higher finance charge than the amount stated in the RAL application, nor the amount of the difference between finance charges stated in the RAL application and the actual finance charge, nor how many RAL applications left the finance charge blank. He also gave numbers that he said were RAL license fees paid to Block by Beneficial in particular tax seasons and saying it had provided responsive documents. Very little actual information is provided and the response is, as previously indicated, unsworn. Settlement counsel did not take Mr. Adducci's deposition or the deposition of any Beneficial employee to try to verify even this information.

At some point, plaintiffs' expert (or someone employed by him or plaintiffs' counsel named Gene Leeb) sought information from Block concerning materials provided its tax preparers pertaining to RALs and electronic filing. Louise Ellingsworth, Block's counsel, responded in a letter dated October 12, 1999, stating that such information was contained in any of 10 to 14 reference volumes prepared every year and that plaintiffs' counsel would need to go to Kansas City to look at them or pay for the material. She also insisted on the entry of a protective order or signed confidentiality agreement before she would produce the material. On October 15, Ms. Ellingsworth provided Mr.

Harris with random samples of RAL applications from two cities. On October 19, Mr. Leeb wrote Ms. Ellingsworth again requesting copies of training manuals and Block brochures for various years so that "we may report to the court that our work is completed." There is no indication the information was provided. On November 24, 1999, Ms. Ellingsworth wrote Peter Linden, one of the attorneys for plaintiffs in New York who are objecting to this settlement, describing the discovery it had provided plaintiffs' counsel as copies of court decisions in RAL cases, the amount of license fees paid by RAL lenders to Block, the total volume of RALs made through Block offices, and the estimated distribution of RALs among various lenders.

In December, 1999, Mr. Adducci wrote Ms. Schwartz two letters in which he said he was answering her questions about the calculation of finance charges in Beneficial RAL loans. On April 7, 2000, it appears that counsel for Block provided someone a list of documents contained in various boxes. While Mr. Miller states in his affidavit that these are a list of documents produced he does not say to whom or when they were produced. By the date, I would guess that if they were produced in this case it was in response to the objectors' formal request for the production of documents.

Settlement counsel did notice depositions in May, 2000 - of the objecting plaintiffs and their counsel.[4] At the same time, they served interrogatories and requests for documents, again on the objecting plaintiffs.

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[4] The only depositions taken in this case were in response to objections to the settlement. In June, 2000, settlement counsel took the deposition of objecting plaintiff Lynne Carnegie and her lawyer, Roger Kirby. Objectors took the depositions of Mr. Harris, Ms. Ellingsworth, and Mr. Adducci and class plaintiffs Turner, Tripplett, and Reynolds.

I have not mentioned every item in the response to my February 19, 2003 order. I have, however, reviewed all of it. When the material is examined it is clear that despite class counsel's statement that "a large amount of informal discovery was taken in this case," in fact, settlement counsel obtained no sworn or verified discovery in this case. In fact, also, there was very little informal discovery, and almost none before counsel had negotiated and reported to Judge Zagel that they had settled the case. It also does not appear that the more pertinent inquiries (by Ms. Schwartz) were ever answered, and if they were, in unsworn responses, no follow up discovery was taken to verify the responses by counsel. No employees at any defendant were ever deposed as to the numbers provided by defendants or any information at all about what Block or Beneficial (or the other lenders) were told to tell their tax preparation consumers about RALs and electronic filing of tax returns or about what they knew about these consumers and how they marketed to them. Half of the response provided to my order concerns discovery either of objecting plaintiffs or their counsel or discovery sought by them after they intervened to object.

Settlement class counsel attempt to augment the nonexistent discovery in this case by reference to discovery in earlier RAL cases in which they participated. They refer to *Beckett v. H&R Block, Inc.*, 1994 U.S. Dist. LEXIS 17714, 94 C 776 (N.D. Ill.) ("*Beckett I*"), *Beckett v. H&R Block, Inc., No.* 95 CH 10112 (Cir. Ct. Cook Cty.) ("*Beckett II*"), and *Adams v. Jackson Hewitt, Inc.*, 95 CH 11825 (Cir. Ct. Cook Cty.). Counsel include copies of document requests made in those cases. However, it appears from the correspondence referring to the requests that the only responses ever obtained to the requests were transactional documents for the named plaintiffs, some Block advertisements for its product and prototype RAL transaction forms. Plaintiffs' counsel also issued formal discovery in the

Adams v. Jackson Hewitt case, discussed earlier in this opinion, but any discovery responses, and the record before me does not indicate there were any despite counsel's reference to correspondence which is not attached, were once again "confirmatory." Ms. Schwartz, who seems to have done most of the work in the earlier cases, included in her time records for this case her time spent on the earlier cases. While there was substantial time spent drafting pleadings and discovery, there is almost no time documented on reading any responses.

There is one limited exception to the total absence of meaningful discovery disclosed by this record. At the end of August, 1999, class counsel were allowed to examine documents produced in the New York *Affatato* case. Only Ms. Schwartz did so, spending, according to her time records, a substantial part of several days looking at documents. A list of those documents, as well as deposition transcripts from the *Affatato* case, are included in the materials provided to me. I do not know who the deponents were nor can I assess the relevance of those documents. Ms. Schwartz did not testify at the fairness hearing so I do not know what she looked at or what she learned. Whatever their relevance, and however long Ms. Schwartz looked at the documents, she did not learn answers to her questions from her time spent looking at them. A week later, on September 7, 1999, according to her time records, she again told Mr. Harris that she needed answers to her earlier questions. The next day she drafted questions for her expert. There is no indication in her time sheets that she examined any discovery responses after this time.

Ms. Schwartz' time records contain numerous other notations showing that counsel's statement now that they had all the discovery they needed to decide on a fair settlement is untrue. On June 16, 1999, her time records state she had a

telephone conversation with Mr. Adducci and adds "can't proceed with settlement without discovery what's going on?" Her time records for July 21, 1999 indicate a court appearance before Judge Zagel at which Mr. Harris informed the court that he and Mr. Prossnitz had accepted defendants' offer of settlement. She says she and an attorney from the Miller firm objected saying "Adducci has not answered my questions regarding fees and number of RALs - how can Harris accept proposal w/o confirmatory discovery; meeting after court w/Harris tell him I'm not on board until I see numbers and my questions are answered." On July 27, 1999, she notes another telephone conversation with Mr. Adducci, saying "still missing discovery, how can I accept settlement w/o adequate discovery?" Again, on August 10 and 23 she indicates she does not have discovery needed to assess a settlement proposal.

Various statements from other lawyers in this case confirm that Ms. Schwartz' contemporaneous statements that she did not have the discovery necessary to evaluate the fairness of a settlement proposal were more accurate than the statements made to me in counsels' response to my recent order. In his deposition, Mr. Harris admitted that at the time he made his initial settlement offer in the case, he did not have any informal discovery with respect to the claims against Beneficial, further contradicting the present claim that class counsel had obtained discovery in other cases that obviated the need for discovery in this case. On September 21, 1999, Mr. Miller wrote Messrs. Adducci and Rublin regarding a telephone discussion they had about one of the settlement drafts and discussing agreement over terms. In the letter, Mr. Miller also states that they have agreed that "defendants are to provide to plaintiffs' counsel all discovery taken in the other pending actions and such additional discovery as may be reasonably required to evaluate the above terms in light of defense counsel's representations."

Despite this, so far as the record shows, documents produced in cases in Maryland (*Green*) and Pennsylvania (*Basile*) cases were not provided to settlement counsel, and there is no indication that counsel insisted on seeing them before agreeing on a settlement. [5]

Settlement counsel nevertheless continue to argue that the settlement in this case is fair and should be approved (with the exclusion, mandated by the Seventh Circuit, of two Illinois cases and, as will be discussed, the Texas case). They say that there was little chance for any recovery, and none exceeding the amount of settlement, if the case had proceeded.

There are two federal claims in the cases before me. The first is a claim under the Federal Truth In Lending Act ("TILA"), 15 U.S.C. § 1601, *et seq.* The Zawikowski plaintiffs claimed that Beneficial violated TILA through inaccurate disclosures of the amounts paid Block by Beneficial and failing to inform the plaintiff consumers of all of the charges they would incur as a result of obtaining an RAL. Turner claimed Beneficial violated TILA by failing to disclose amounts that were paid to Block or some other tax preparer. In early January, 1999, Judge Zagel held that the Zawikowski plaintiffs' claim that Beneficial had failed

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[5] At the hearing in this case, when Mr. Miller was confronted with the fact that he did not have a report from his own expert, Dr. Adler, supporting the settlement until December, 1999, he insisted there was a preliminary report. However, he did not produce it to counsel for objectors, nor provide it as a document in support of the settlement. Indeed, settlement counsel decided not to rely on Dr. Adler as their expert in this attempt to obtain approval of the settlement on remand. There is in the record no support for any preliminary report by Dr. Adler, and in the absence of the report, or indeed of plaintiffs' willingness to rely on his final report (thus making him available for deposition), I will not credit the unsupported testimony that there was such a report.

accurately to state finance charges stated a claim and that if the amounts paid to Block by Beneficial were on plaintiffs' behalf there would be liability under TILA.[6] He later upheld the Turner complaint, including claims brought under TILA.

Although defendants argue that plaintiffs have little chance of prevailing on this claim, settlement counsel state that plaintiffs stand up to an 80 percent chance of success on their TILA claims.[7] Both settlement counsel and defendants

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[6] Plaintiffs also argued that IRS regulations prohibited an electronic filer such as Block from accepting fees from the lender, such as Beneficial, that were contingent on the amount of the RAL. Beneficial successfully argued that this claim should not be considered by Judge Zagel since it was not in the complaint. Plaintiffs did not seek to amend their complaint after entry of this opinion.

[7] Plaintiffs in these cases did not allege a violation of TILA by another practice, alleged in the Zawikowski complaint to violate other laws, and alleged in at least one of the other TILA actions submerged in this settlement. That alleged practice was not to inform consumers of statutory mandated disclosures until they receive the loan check issued by defendants. While some courts have upheld this practice, *see Beckett v. H&R Block, Inc.*, 1994 U.S. Dist. LEXIS 17714, 1994 WL 698505 (N.D. Ill. 1994), in denying a motion to dismiss a TILA claim based on these allegations, Judge Gershon noted that plaintiffs alleged that because a consumer who completes the loan application at H&R Block or another tax preparer "1) commits to paying a charge for having the RAL application considered by the defendants, even if the application is denied; 2) consents to the defendants opening up an account in the consumer's name; and 3) signs Internal Revenue Service Form 8453, which directs the Internal Revenue Service to forward the consumer's income tax refund check to that account." *Affatato v. Beneficial Corporation*, 1998 U.S. Dist. LEXIS 12447, 1998 WL 472494 at 2 (E.D.N.Y. 1998). Judge Gershon agreed with plaintiffs that if proof showed that "these events, . . . effectively bind the consumer to a credit transaction," for instance, by committing the tax refund as collateral for a loan to an account with the defendant, which cannot easily be undone, especially by an unsophisticated consumer, a violation of TILA might be found. Plaintiffs in *Affatato* had moved for summary judgment on all of the TILA claims at the time the settlement in this case ended further proceedings in that case. In their motion they argued that the undisputed

focus on the fact that in the absence of proof of actual damage (which might require individualized proof), damages in class actions under TILA are capped at an amount much less than the settlement in this case. That amount may not be as little as defendant and settlement counsel argue. In a class action, non-actual damages are capped at $ 500,000 for "the same failure to comply by the same creditor." 15 U.S.C. § 1640(a)(2)(B). The release in this case agreed to by settlement counsel released claims against a number of creditors. Nevertheless, it seems unlikely that any potential TILA recovery would meet or exceed the $ 25,000,000 settlement.

The settlement encompasses much more than TILA claims. The second federal claim in these actions is a claim under RICO. Plaintiffs allege that defendants' acts in deceiving plaintiffs in the amount of finance charges they will pay and in failing to disclose Block's interest in the loans constituted a pattern of racketeering with damages, before trebling, that objectors say amounted to $ 374,000,000. Settlement proponents and defendants dismiss the RICO claim as having no value. But Judge Zagel had denied the motion to dismiss the RICO claim, finding that if the facts showed a bait and switch scheme or intentional false disclosure of payments by Beneficial to Block, plaintiffs could prove a violation of RICO. In this

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facts showed that plaintiffs entered into a contract for the loan subject to either the lender's refusal or plaintiffs' later cancellation at the time they applied for the RAL, that plaintiffs would not have been likely to know at the time their checks were presented that they had an option to cancel, that cancellation would entail costs, not all of which were stated, that the RAL application states that the assignment of the IRS refund check to the lender is irrevocable, and that Block charges RAL customers more than non-RAL customers without disclosing the difference in charge or that it is a finance charge.

case because of the lack of discovery it is difficult to evaluate the likelihood of proving plaintiffs' claims. However, two other decisions are pertinent to the inquiry regarding this claim. The Pennsylvania appellate court found, in reversing summary judgment in favor of Block in a related case, that the evidence showed that "many of Block's customers had no significant understanding of the 'Rapid Refund' service," and that Block "exploited 'a corresponding opportunity to abuse [their] trust for personal gain.'" *Basile v. H & R Block, Inc.*, 2001 PA Super 136, 777 A.2d 95, 106 (Sup. Ct. Pa. 2001). In a second case, in December, 2002, in a case brought by the New York City Department of Consumer Affairs, Block agreed to pay New York City Block customers at least $ 35.00 each (17,500 of those customers receiving coupons redeemable for cash in the amount of $ 70.00). The Department in that case charged Block with engaging in misleading and deceptive trade practices, and violating earlier agreements to discontinue the practice of failing "to distinguish between its rapid refund products and refund anticipation loans."[8] If true, the allegations in the New York case and the evidence referred to in *Basile* would support plaintiffs' claims of intentional ongoing fraud. Notably, neither defendants nor settlement counsel have discussed the merits of the RICO claim, merely noting that, contrary to Judge Zagel (whose opinion they neglect to mention), some other courts have dismissed RICO claims.[9] While at this

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[8] Block agreed to pay additional fines and costs, to the entry of an injunction, and to pay the cost of an independent monitor to oversee Block's compliance with advertising and training materials.

[9] One of those cases, *Peterson v. H & R Block Tax Services, Inc.*, 22 F. Supp. 2d 795 (N.D. Ill. 1998), was on summary judgment and not a motion to dismiss. The facts were different, involving Block's negligent action in failing to detect, over a period of a few weeks, the fact that customers claiming earned income tax credits would not receive a quick refund from the IRS. Both the period of duration and the finding of negligence, the two facts upon which Judge Castillo based his decision,

stage of the proceedings (in which settlement proponents never addressed the facts and the record contains no evidence), I cannot determine the likelihood that plaintiffs will succeed on these claims, if it were to turn out that defendants intentionally deceived plaintiffs over the lengthy period alleged, plaintiffs might well be able to satisfy even the demanding requirements of RICO.

Plaintiffs' allegations also include state claims. As the Seventh Circuit's opinion noted, before this settlement blocked further proceedings, a class action asserting claims for breach of fiduciary duty had been set to go to trial in Texas. Following the Seventh Circuit's opinion, that case was reset for trial. In November, the trial judge granted summary judgment in favor of plaintiffs on the breach of fiduciary duty claim, and awarded damages in the amount of $ 74,900,000. While defendants argued before that decision that even if plaintiffs won in the trial court in Texas, any decision would not hold up on appeal, almost immediately after the trial court ruled in favor of plaintiffs, Block agreed to a settlement of $ 49,000,000 in cash and various software and coupons.

Apart from the Texas case, while plaintiffs had not fared well on this claim (Judge Zagel had dismissed the claim in

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distinguish the case from the claim, as alleged, in this case. The other two cases cited by defendants (Mr. Macey's brief) are *Christiansen v. Beneficial National Bank*, 972 F. Supp. 681 (S.D. Ga. 1997), and *Rizzo v. H & R Block*, No. 95-1001 CV-W-$ (W.D. Mo. 1996). But *Christianson's* theory was different from that alleged here and counsel have shown no reason to defer to the finding in *Rizzo* that plaintiffs there had failed to adequately allege an enterprise in the face of Judge Zagel's conclusion that plaintiffs stated a RICO claim. Defendants in reply refer to my decision in *Clark v. Robert W. Baird Co., Inc.*, 142 F. Supp. 2d 1065 (N.D. Ill. 2001). That decision involved far different facts from those alleged in these cases and does not support defendants' position.

this case, and there is an Illinois appellate case reaching the same result), two recent cases had upheld claims under allegations similar to the facts alleged in these cases. Maryland's highest court, in a related case, held that Block had admitted that "it acts as an agent for its customers for the purposes of preparing the tax return and filing it with the IRS." *Green v. H & R Block, Inc.*, 355 Md. 488, 735 A.2d 1039, 1049 (1999). Block also conceded that it acts as its customers' agent in transmitting the RAL application. *Id.* at 1050. While Block argued that its agency relationship terminated at that point, the court, comparing the taxpayer-H&R Block relationship with that of a typical attorney-client relationship, in which an attorney acting as a negotiator generally acts independently in determining strategy, although the client retains ultimate decision making authority, held that:

> Like the attorney representing a client in settlement negotiations, H & R Block undertakes to file customer tax returns with the IRS and the loan application with the bank, but only at the direction of the customer, who ultimately controls whether H & R Block takes either action with respect to the third party. It is not dispositive . . . that H & R Block's customers do not generally exercise control over the manner in which H & R Block prepares the tax filings. Indeed, H & R Block conceded at oral argument that it serves as its customers' agent for the purpose of filing the tax return and transmitting the loan application to the lender. Thus, H & R Block's customers retain enough control over H & R Block to support a finding of an agency relationship.

Id. at 1051.

The court also concluded that although the customer ultimately signs the loan document, Block's role in the application process creates a reasonable inference "that H & R Block played an integral part in the customer's receipt of the bank loan, which indisputably has legal ramifications for the H & R Block customer and the bank." *Id.* at 1053. Finally, the court noted that Block's advertising "strives to convince potential customers that it can be 'trusted' to obtain both the highest and fastest possible refunds for its customers," and that its "advertisements promoting its ability to secure a 'Rapid Refund' constitutes an integral part of its promotional efforts." *Id.* The court concluded that Block intended to create the circumstances under which customers would trust it to obtain the maximum refund fast" and customers may have "reasonably believed that H & R Block is operating as their broker . . . finding for its customers the best loan package that fulfills H & R Block's twin commitments of maximizing tax refunds in terms of amount and speed." *Id.* at 1054.

The Pennsylvania appellate court also concluded that the facts of Block's relationship to its customers in obtaining RALs created a triable issue as to whether Block had a fiduciary duty to its RAL customers. That court concluded that the evidence was "sufficient to make a *prima facie* showing that the Plaintiffs and Block engaged in a confidential relationship." *Basile,* 777 A.2d at 103. It noted that Block "actively sought customer trust in H & R Block as a corporate entity and in all of the services Block offered." *Id.* It further found that "as documented by multiple focus group studies commissioned by Block, the company was aware of the limited economic and educational standing of its customers, their confusion about the 'Rapid Refund' service, and the fact that they trusted the company to 'take the worry out.'" *Id.* The court noted that a confidential relationship "may exist 'wherever one occupies toward

another such a position of advisor or counsellor as reasonably to inspire confidence that he will act in good faith for the other's interest.'" *Id.* Finally, the court held that if plaintiffs established a fiduciary relationship, reliance would be presumed. *Id.* at 107.

Settlement counsel's statement that the Seventh Circuit was mistaken in taking seriously the breach of fiduciary claim and that these claims have "been consistently dismissed by courts for failure to state a cause of action" cannot be reconciled with these decisions nor with Block's settlement of the Texas case in an amount that exceeds the entire settlement in this case. Defendants argue that I have now carved out the Texas case from this one and so the settlement there does not affect the fairness of the settlement in this case. In the first place, while I allowed the Texas case to proceed, the members of the Texas class will have to be sent a supplementary notice before they can actually be severed.[10] Secondly, the opinions in Maryland and

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[10] The value of the Texas settlement to Texas class members is unclear at this point. Counsel for Block stalled for weeks in providing any settlement agreement on the grounds that despite a press release from Block announcing the settlement, there was not yet a written settlement agreement, and then, in response to a further order to provide any writing having to do with the settlement, provided, in February, a "Memorandum of Understanding," dated November 18, 2002, which they claimed was not a settlement agreement. That 13 page memorandum appears to contain every element of settlement, and is in form what would ordinarily be considered a settlement agreement. Counsel have now submitted the final settlement agreement, which, indeed, contains the terms stated in the Memorandum of Understanding. Under the settlement, Block agrees to pay up to $ 49,000,000 to counsel (with court approval), with class members obtaining coupons entitling them to "discounts" on future services and computer software for tax services. The agreement obligates counsel for the Texas plaintiffs to withdraw objections to the settlement before this court. Subsequent to my receipt of the Memorandum of Understanding, Texas counsel submitted to the Texas court a "Motion for Release of Funds," which asked the Texas court to pay $ 26,000,000 of

Pennsylvania might lead to reconsideration of the court's decision dismissing the fiduciary duty claim based on additional pleadings of the breach of fiduciary claim in this case.[11] Finally, the Seventh Circuit's point primarily was that the settlement did not seem to value the other cases that had upheld these claims against motions to dismiss and that were subsumed within the settlement. In hindsight, of course, the Seventh Circuit was correct, as shown by the recent Texas settlement. The Maryland case remains pending, and it must be assumed, given Block's recent settlements of cases in Texas and New York that it had (and if this settlement is not approved, has) value that is likely to exceed the settlement in this case.[12] Given the outcome of the *Haese* case in Texas,

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the $ 49,000,000 in "attorney fees" to the Texas class. In response to that motion, Block informed the Texas court that no one had yet filed an application for preliminary approval of the settlement, although the settlement had been agreed upon three months earlier. The allocation of attorneys fees to plaintiffs is not in the final settlement agreement. There appear to be two possible scenarios: the Texas class was settled for almost $ 50,000,000 in attorneys' fees, with the class to receive nothing more than coupons of probably little value to at least most plaintiffs, or in fact the class - just one portion of the class in the present case - is itself to receive more than the entire settlement in the case before me but counsel are attempting to hide this fact until the present settlement is approved.

[11] The Illinois appellate opinion that declined to find a fiduciary duty owed by Block relied on *Peterson v. H & R Block Tax Services, Inc.*, 971 F. Supp. 1204 (N.D. Ill. 1997), and dismissed the claim before it based on the pleadings. *Beckett v. H&R Block, Inc.*, 306 Ill. App. 3d 381, 714 N.E. 2d 1040, 239 Ill. Dec. 736 (1st Dist. 1999). Judge Castillo thoroughly analyzed the claim before him in *Peterson* but found only that on the facts alleged plaintiff could not show an agency relationship. Neither opinion forecloses a different outcome if the facts alleged would prove an agency relationship. I also note that one of plaintiffs' counsel, Mr. Harris, now seeks a court ordered modification of the settlement to exclude state fiduciary claims in certain states on the ground that these claims might succeed.

[12] The Pennsylvania case (*Basile*) also remains. Unlike the Texas and Maryland cases, it was formally excluded from the settlement. However,

and the appellate opinions in *Green* and *Basile*, defense counsel's dismissal of the fiduciary duty claims in this case as having only a 3-5 percent chance of success must be rejected.

Liability under TILA may also result in liability under state consumer fraud laws, which do not have caps on damages. Settlement counsel dismiss these claims as having only a 15-20 percent chance of success with this analysis: "While it may be misrepresentation or fraud as to the amount of the fees, they knew they were paying fees and they got exactly what they intended and requested to receive. Therefore, there is probably no bait-and-switch because they did not get something different from what was expected." Report of Philip N. Hablutzel at 9.[13] Mr. Hablutzel does not refer to Judge Gershon's analysis or Judge Zagel's denial of the motions to dismiss in these cases. His argument also does not discuss what objecting plaintiffs claim were undisputed facts to the contrary in their motion for summary judgment in *Affatato*. Neither does Mr. Hablutzel (nor defendants) discuss the Maryland Court of Appeal's decision in *Green v. H&R Block*, 355 Md. 488, 735 A.2d 1039 (1999), which also held that similar allegations regarding Block's RALs stated claims under that state's consumer fraud laws or the case brought by the New York Department of Consumer Affairs.

None of the settlement proponents has attempted to value the injunctive aspect of this case although the Seventh Circuit

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the Block customer claims against the banks in Pennsylvania who provided the RALs are released by the settlement. No one has addressed how that would affect the claims against Block.

[13] Az noted earlier, I have considered this report, and those of other lawyers/professors, as additional briefs. I refer to it here because these reports are the principal basis on which settlement proponents claim the settlement is adequate.

had noted the failure to value and lack of discussion. Counsel for certain plaintiffs mention it only in a footnote and say it is impractical to assign a value. Other plaintiffs' counsel refer vaguely to injunctive relief and say only that it is "significant." Defendants never discuss it. The reason may be that there is not in fact an injunction requiring defendants to make any disclosures in the future. The settlement agreement does provide that defendants shall in the future disclose at the time of application for an RAL the amount of any license fee paid to Block, the customer's fees, and a TILA disclosure. Neither the agreement nor any other document in the court file, however, provide for a form of injunction, state how long the agreement to make these disclosures is to remain in effect, how prominent the disclosure must be, provide language of disclosure, or, for example, prohibit defendants from making any oral statement that would negate the written disclosure. Thus, the value of equitable relief is insignificant and probably nonexistent.

In summary, counsel for the settlement plaintiffs have been inadequate representatives of the plaintiff class for all of the reasons discussed in this opinion. Not surprisingly, therefore, they have failed to sustain their burden of showing that this settlement is fair. It is apparent that they do not have the discovery necessary to provide a serious analysis of the chances of recovery on any theory in this case. They never attempted to obtain that discovery. Lacking this, their submissions in support of the settlement (and it should be remembered, counsel in one of these cases has now agreed that without modification the settlement should not be approved) have focused on decisions in which plaintiffs have lost and ignored altogether, or given short shrift to, those decisions that have found merit in claims raised in these cases. Defendants have been similarly unhelpful. Without adequate representation by plaintiffs' counsel, it is impossible to evaluate the chances of plaintiffs obtaining a

greater recovery than under this settlement with any greater precision than noted in this opinion. Notably, in two cases that have settled since this settlement was submitted to me, defendants have been willing to pay substantially more than they agreed to pay in settlement of this case although only the present case would settle nationwide claims. Those settlements provide some concrete indication of defendants' recognition that their position may not be as strong as they and class proponents represent.

For each of these reasons, I decline to approve the settlement proposed to this court. Settlement counsel will not be permitted to continue to represent the class in this case. Other counsel seeking to represent the class shall be prepared to make a presentation at a status hearing, to be set by separate order.

ENTER ORDER:

Elaine E. Bucklo

United States District Judge

Dated: April 15, 2003

APPENDIX E

AGREEMENT OF SETTLEMENT

This Agreement of Settlement (the "Agreement") is entered into this 26th day of October, 1999, by and between Household Bank, f.s.b. (successor in interest to Beneficial National Bank, "Beneficial"), Household Tax Masters Inc. (formerly known as Beneficial Tax Masters, Inc.) (collectively "Household"), H&R Block, Inc., Block Financial Corporation, H&R Block Tax Services, Inc., H&R Block Eastern Tax Services, Inc. and H&R Block and Associates, L.P. (collectively "H&R Block"), on the one hand, and DeCarlo Turner ("Turner"), Cheryl Reynolds ("Reynolds"), and Nannie Triplett ("Triplett") (collectively "Plaintiffs"), on behalf of themselves individually and on behalf of the Class as defined below.

* * *

14. In the event that the settlement does not become final in accordance with the terms hereof, then this Agreement shall be of no force or effect and, in any event, the parties hereto agree that this Agreement, whether or not it shall become final, and any and all negotiations, documents and discussions associated with it, shall be without prejudice to the rights of any party, shall not be deemed or construed to be an admission or evidence of any violation of any statute, law or regulation or of any liability or wrongdoing by any of the Released Parties or of the truth of any of the claims or allegations made in the Complaints in the Zawikowski or Turner Actions or any other pleadings, and evidence thereof shall not be discoverable or used directly or indirectly, in any way, in any action or proceeding. Household and H&R Block expressly reserve all of their rights if the settlement does not become final in accordance with the terms of this

Agreement, including their rights to contest class certification in the Zawikowski and Turner Actions.

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